Banking on the public: market competition and shifting patterns of governance

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Publication date
2011

the Euromarkets) shifted the preferences of public and private actors and led to the abolition of the Bretton Woods governance pattern. The chapter furthermore provides an elaboration on the role and functioning of the main actors and institutions as they emerged and developed over the period of the cases. This is set against the background of a trend of financial integration and expansion that continued over the period of our case studies. As such, the chapter provides the background to the arguments developed in this thesis.

The fourth chapter deals with the first case study of bank capital adequacy standards. It traces the changes in governance (from the Basel I Capital Accord to the Basel II Capital Accord) and the accompanying changes in the market structure (mainly consolidation and internationalisation and the accompanying change in business models). The chapter will highlight the relation between the two by showing the impact of Basel I on the banking market, as well as how the subsequent changes in the market structure also led to shifting preferences for governance. These shifts stimulated the renegotiation of Basel I. The chapter offers an explanation for the shifts in governance from Basel I to Basel II in the exclusionary policymaking institutions that result in private sector preferences that exert a strong influence on the policymaking process. These exclusionary, club-like policymaking institutions also lead to groupthink favouring financial sector interests.

In the fifth chapter, the sovereign debt crisis resolution case study is analysed showing developments from the Latin American debt crisis to the policy proposals in the wake of the East Asian crisis of the late 1990s. This shows how the governance pattern developed after the Latin American debt crisis – which was focused on public actors - failed to address the challenges that the growth and diversification (in the sense of increasing private capital market funding) of the market for sovereign debt posed. After the East Asian crisis, important proposals countering the 'laissez-faire' governance pattern of the late 1990s were put on the table, but defeated by a successful lobby of market actors (both creditors and debtors).

In the final chapter the argument will be summarised and conclusions will be drawn. The chapter will illustrate the contribution of the theoretical approach used in this thesis, but will also identify some challenges for future research. Also, the implications of the current crisis for the arguments put forward in this thesis will be discussed by providing an 'update' of the case studies. In other words, the policymaking processes of Basel III and the resolution of the sovereign debt crisis in the Eurozone are tentatively analysed. Finally, the concluding chapter will discuss the implications of the research for both IPE and society at large.

Chapter 2

Theorising the global financial system: governance, market structure and the policymaking process

In this chapter, the theoretical approach that will be used to analyse the dynamics of the global financial system in the two policy domains of this study is developed. As the opening anecdote of the Introduction made clear, at the time of writing a global financial crisis is having a significant impact on the financial system and – more importantly – the socio-economic prospects of millions of people. Notwithstanding the urgency and uniqueness of the current crisis, it can be noted that the development of financial systems has historically always been accompanied by financial crises. As has been abundantly documented empirically[1] as well as modelled theoretically:[2] financial markets are not stable. However, the severity and (global) contagion effects of financial crises may vary depending on the prevailing market structure in financial markets, as the likelihood of prevention, containment and efficient resolution of crises is closely related to the governance pattern of the financial system.

With the fall of the Bretton Woods system of governance, the internationalisation of financial markets accelerated. However, this also implied that, for example, banking crises had important cross-border repercussions (underscored by the Herstatt Bank failure).[3] National level patterns of governance and domestic authorities were faced with international linkages created by global financial market integration, and were consequently no longer able to deal with financial crises single-handedly. However, while financial firms were allowed to compete on a global scale, crucial aspects of the governance pattern seemingly 'lagged behind' in important respects, increasing the potential mayhem financial crises could cause.

Given the known likelihood of financial instability – and its detrimental consequences – it is puzzling that a pattern of financial governance that mitigates the worst financial instability ex ante has not emerged. A related puzzle concerns the relation between global market integration and governance. While there are many theories of shifting patterns of governance, none seems to be able to satisfactorily explain why it is that some aspects of governance apparently 'follow the market' and shift to the global level while others remain national, especially

1 Bordo et al., 2001; Kindleberger & Aliber, 2005; Reinhart & Rogoff, 2009.
2 E.g. Minsky, 1982.
3 These developments will be elaborated in the next chapter, which provides the historical background to the case studies of this thesis.

when we look at the 'public' provision of governance.

These puzzles cut to some of the core issues in International Political Economy (IPE) such as the relation between states and markets, the interaction between different levels of analysis and the relation between public and private actors.[4] Furthermore, it links to an important debate in the literature concerning the role of states in globalising markets. Are state agencies receding in the face of the pressures of global financial markets, or is the state still the crucial institution in the governance of the global financial system?[5] Assembling some pieces of these puzzles will therefore contribute to a long tradition of thinking about the relationship between states and markets, and will demonstrate the value of IPE as an '(inter) discipline'[6] bridging debates in (Comparative) Political Science, International Economics and International Relations to come to a fuller understanding of the contemporary global political economy. An analysis of the dynamics of the global financial system can therefore be embedded in a rich diversity of cross-disciplinary literature on the political economy of finance, at both international and domestic levels of analysis.

In this chapter the two related puzzles are addressed, and in doing so a theoretical approach is developed that is suitable to address the central question of this thesis (what explains the relationship between market structures and patterns of governance). This central conceptual concern informing the thesis is addressed through three research questions, which were derived from the central question in the Introduction. Each of the research questions brings its own set of theoretical considerations, focusing on different bundles of literature. The main purpose of this chapter is to provide the theoretical groundwork for dealing with the research questions by embedding the analysis in these different bundles of literature. In integrating these literature debates – which each focus on part of the central conceptual concern – the chapter will work towards resolving the two puzzles.

The first research question (how has the pattern of governance shifted in the two policy domains of bank capital adequacy standards and sovereign debt crisis resolution over the period 1980 - 2005 and how have the relevant market structures changed over the same period) points to the importance of the concept of governance in this thesis: what do we understand governance to be, in relation to the understanding of market structure? As the discussions of the cases in the Introduction showed, there seem to be different dimensions to governance patterns and shifts across these dimensions may vary. A first conceptual goal of this chapter is thus to analytically elaborate and clarify the concept of governance. Similarly, it will be discussed how to conceptualize market structure. This will allow for an analysis of how the pattern of governance has changed in the policy domains of the cases.

A second theoretical issue follows from the research question concerning the characteristics of the policymaking process leading to these shifts in the pattern of governance. This issue speaks to a bundle of literature dealing with political processes that produce specific patterns of governance. This extensive bundle of literature cuts across the disciplines of Economics, (I)PE, Political Science and Sociology. This literature provides useful building blocks (summarised as ideas, institutions and interests) to achieve the second conceptual goal of this chapter: to come to an understanding of the political process leading to shifts in governance through addressing these building blocks and the links between them.

A third theoretical issue bridges the previous two by dealing with the relationship between the policymaking process, its outcomes in the form of shifting patterns of governance, and how this relates to changing market structures. This debate addresses the third research question (the relation between shifting patterns of governance and changes in market structure) and links back to the general theoretical notion of the state-market relationship. The third conceptual goal of this chapter is therefore to build a theoretical 'model' of the mutually constitutive relationship of governance and market structure.

These theoretical issues will be elaborated below, and together work towards a simultaneous explanation of governance patterns and market structures by means of a feedback loop. This feedback loop derives from an analysis of the policymaking process that focuses on the interaction between preferences (interests), ideas and policymaking institutions. The shifts in governance that are the outcome of this process lead to new incentives and constraints for market actors ('terms of competition'), and hence to changing market structures. These changing market structures lead to new preferences of both public and private actors with regard to governance patterns, which feed back into the policymaking process. Bringing the different sets of literature together in this manner will lead to a number of propositions, which will conclude the theoretical discussion.

The approach posited above and elaborated in the remainder of this chapter makes two – related – contributions to the literature. First, a focus on either market actors and market behaviour on the one hand, or on governments (states) on the other hand is overcome by understanding the dynamics of the global financial system through the simultaneous interaction between public and private actors in markets and policymaking processes. The policymaking process functions as the conduit between changing market structures and shifting patterns of governance, creating a feedback loop. It will be argued that this innovative approach contributes to a better understanding the dynamics of the global financial system, and - more generally - also of complex political-economic phenomena such as globalisation or economic development processes.

Second, and related to the first, this integrated account will provide new insights into the role of the state (public actors) in globalising markets. It allows us to gain insights into the way state agencies adapt to the pressures of globalisation. The feedback loop proposed here prevents us from seeing shifting patterns of governance as a one-way retreat of the state in the face of global markets. The intended and unintended consequences of this feedback loop provide space for state actors to exert agency. This contributes to a better understanding and

[4] Krätke & Underhill, 2006.
[5] For the former side of this debate, see, for example, Strange, 1996; for the latter Weiss, 1998 and Cerny, 2005.
[6] Underhill, 2000.

more nuanced position on the circumstances under which states adapt to the pressures of globalisation.

The set-up of this chapter is as follows: The first section discusses the emergence of the concept of governance, and positions the conceptualisation of governance used in this thesis in the literature. Furthermore, to clarify this broad concept, three dimensions of governance will be distinguished at the analytical level: (i) the level of jurisdiction to which the governance pattern applies, (ii) the nature of the authority involved in governing and (iii) the stringency of the governance pattern.

The second and third sections turn to explanations of shifts in governance. In the second section, the contributions from institutional theories rooted in Sociology and Economics, respectively Historical Institutionalism (HI) and New Institutional Economics (NIE), are discussed. As the discussion will show, while these approaches make important contributions, their main drawback is that they predict stability instead of the change witnessed in the preliminary case descriptions of the previous chapter. HI and NIE lack an adequate explanation of the policymaking process leading to shifts in governance.

The third section therefore adds a model of the policymaking process to the two institutional approaches. It does so by discussing the building blocks characterising policymaking processes that emerge from the IPE literature. This body of literature offers preferences (interests), ideas and (policymaking) institutions as the main categories of explanatory factors for policymaking processes. It is argued that a proper account of the outcome of the policymaking process can only be given by coming to an integrated analysis of these three factors.

In the fourth section the framework comes full circle by linking the previous steps to changing market structures, thereby responding to the third set of theoretical considerations concerning the relationship between the policymaking process, its outcome in the form of shifting patterns of governance and how this relates to changing market structures. In this section it is also argued that such a theoretical approach, which bridges the various literatures discussed in this chapter, works towards simultaneously explaining changing market structures and shifting patterns in governance, and consequently also works towards understanding the dynamics of the global financial system.

After developing this theoretical model of the dynamics of the global financial system, the fifth section will relate the theoretical discussion to the arguments made in this thesis and the propositions that follow from the approach. A final section discusses methodological issues and is followed by a brief conclusion.

Conceptualising global financial governance

As mentioned in the Introduction, in this study governance refers to the rules and regulations shaping the behaviour of actors in the financial system. Importantly, this concerns not only rules and regulations emanating from states but also those emanating from non-state actors. This fits with the case descriptions from the Introduction that highlighted the important role of private actors and different forms of authority in the governance of the financial market. Below, this section first elaborates the emergence of governance as a theoretical concept, showing how the notion has encouraged a rethinking of the variety of actors involved in the state-market relationship. Second, the concept of multilevel governance is introduced and analytically clarified by distinguishing three dimensions (jurisdictional level, nature and stringency) across which shifts in governance can be mapped.

The emergence of the concept of governance in relation to IPE

With the emergence of internationally integrated financial markets in the 1970s, scholars like Cohen, Gourevitch and Strange began to call for a more general study of the relationship between political authority and markets at the international level. They drew attention to the influence of the international dimension in governance and political economy in general, and can thereby be seen as founders of modern IPE.[7] Despite a variety of approaches, the focus was on the interaction between states and globalising markets. In the Comparative Political Science literature, a similar debate has been framed around the question of convergence of national varieties of capitalism. Comparative political scientists examined different varieties of capitalism and their patterns of governance of the financial system.[8] These studies took both market and government (state) variables into account, commonly identifying Anglo-Saxon market-based (financial) systems and Coordinated Market Economies, which often have bank-based financial systems.[9]

The advent of (financial) globalisation led to an interdisciplinary debate on the role of the state in relation to global markets. Susan Strange provocatively claimed that "the impersonal forces of world markets are now more powerful than the states to whom political authority over society and economy is supposed to belong. Where states were once masters of markets, now it is the markets which, on many crucial issues, are the masters of the governments of states."[10] Comparative political economists wondered whether "financial deregulation could be the string that unravels coordinated market economies."[11] On the other hand, scholars started to point to the capacity of states to adapt to globalisation and to the role of states as drivers of globalisation. In other words, the powerless state was a 'myth'.[12]

7 Strange, 1970 and 1976, Cohen, 1977 and Gourevitch, 1978. See also Cohen, 2008 for an intellectual history of IPE (which also provides an extended account of the founding scholars).
8 E.g. Zysman, 1983; Moran, 1986 and 1991.
9 Hall & Soskice, 2001. Market-based in this context refers to the fact that corporate financing in the Anglo-Saxon system is based on securities (stocks, bonds), which are easily tradable in secondary markets.
10 Strange, 1996, p. 4.
11 Hall & Soskice, 2001, p. 64.
12 As an important contribution claimed: Weiss, 1998.

Scholars started to unpack the relation between states and globalising markets to understand how the state would adapt, or under what circumstances we might see retreat or adaptation by the state.[13] Yet, in the debate the focus seems to have shifted away from the role of the state to such an extent that Schmidt recently called for "bringing the state back in yet again."[14] This thesis will contribute to this debate by advancing a theoretical understanding that overcomes the state-market dichotomy that is either implicitly or explicitly present in much of this literature. The approach builds specifically on the work of Underhill who introduced the state-market condominium as his conceptualisation of this point.[15]

Analytically separating the domains of states and markets (even if only implicitly) risks underappreciating the mutually constitutive relationship between the two and the power relations this implies, as will be discussed in more detail below. The approach taken here stands in the tradition of the classic analysis of the industrial revolution by Karl Polanyi that demonstrates how markets are actively constructed by states, and how well-functioning markets are necessarily institutionally embedded in patterns of authority promulgated by the state.[16] In other words, the structure of the market is embedded in patterns of governance.

Market structure will be conceptualised in this thesis based on the 'structural analysis' of Michael Porter.[17] In this conceptualisation five elements determine a market structure: (i) the rivalry among existing firms in the market; (ii) the bargaining power of buyers; (iii) the threat of new entrants to the market; (iv) the threat of substitutes emerging; and (v) the bargaining power of suppliers. These structural features of industries (markets) together "determine the strength of the competitive forces and hence industry profitability."[18] An analysis of the market structure consequently warrants an analysis of the main features of market participants (both on the supply and demand side), new entrants and potential substitutes. These different elements of the market structure cannot be separated from the domain of the state, as in the case of the market being opened up to new entrants through trade liberalisation, for example. As another example, in the case of sovereign credits the demand side (the actor requesting credit) is composed of state actors.

The concept of 'governance' is well suited to overcome (implicit) state-market divides, and could be seen as the modern conceptualisation of Polanyi's institutional embedding. The conceptualisation of governance used in this thesis will be elaborated in the next subsection.

13 Garret, 1998; Burgoon 2001; Mosley, 2003; Busch, 2009.
14 Schmidt, 2009. The 'yet again' refers to an earlier call for bringing the state back in by Evans et al., 1985.
15 See Underhill, 2003 and 2007b.
16 Polanyi, 2001 (1944).
17 M. Porter, 1998 (especially chapter 1).
18 M. Porter, 1998, p. 4.

Conceptualising multilevel governance

The concept of governance has been developed in a burgeoning, interdisciplinary body of literature, which emerged in the 1990s.[19] Van Kersbergen & van Waarden point out that the Online Contents catalogue of academic journals returned 24 hits on the term 'governance' in 1990 and 510 hits in 1999, rising to 603 in 2000.[20] While becoming a cottage industry, studies on governance ran the risk of going the same route as studies on globalisation: a concept turning into a catch-all phrase that functions as an intellectual buzzword.[21] Its wide usage has led to a situation where governance means a great variety of things to a great number of different scholars. Eurocrats talk about governance through the open method of coordination,[22] the World Bank talks about good governance as an underpinning of successful development[23] and International Relations scholars like Rosenau talk about governance without government.[24] When they do, however, they each refer to quite different developments in the global political economy. Therefore, this subsection will first clarify the conceptualisation of governance to be employed in this work, showing its added value and placing it in the context of the literature. Subsequently, the subsection will focus on global financial governance, and will distinguish three dimensions of governance: jurisdictional, nature and stringency.

Two strands of literature can be distinguished, which each focus on different elements of governance. On the one hand there are studies that focus mainly on the process of generating the rules and regulations shaping actors' behaviour, while on the other hand there are studies that focus on the characteristics and nature of the actual rules and regulations. This study bridges these two strands of literature by linking the policymaking process to shifts in the characteristics of governance.

The first strand of literature, focusing on the pattern of interaction of actors, primarily evolved out of the literature on policy networks and policy communities,[25] but also has a strong base in European Studies (e.g. studies on the open method of coordination or experimentalist governance).[26] The emphasis in this literature lies on the inclusion of new and diverse actors in the policymaking process, pointing to the importance of not only understanding the role played by public (governmental) actors in policymaking processes, but also of the role played by private and civil society actors.[27]

19 For reviews of the literature, see Van Kersbergen & van Waarden, 2004; Brunnengraeber et al., 2006; and Treib et al., 2007.
20 Van Kersbergen & van Waarden, 2004, p. 144.
21 For a discussion and further references on this trend with the concept of globalisation, see Busch, 2009, p. 1 - 5.
22 Based on Sabel & Zeitlin, 2010.
23 World Bank, 1997.
24 Rosenau, 1992.
25 See, for example, Rhodes, 1997.
26 See Zeitlin & Pochet, 2005.
27 Treib et al., 2007, refer to this as their first category of governance conceptualisations, which is focused on politics. Their second and third categories are then based on, respectively, polity and policy and overlap more closely with the approaches to governance that focus on the rules and regulations (which will be discussed next).

The second strand focuses on the characteristics and nature of the actual rules and regulations that form the governance pattern, or in other words on the outcome of the policy-making process and its effects on actor behaviour. These studies originate from International Relations, for example, where governance is a logical concept to use in the absence of an overarching government in the international realm. An early contribution to the development of the governance concept in International Relations was made by Krasner's introduction of the concept of regimes. These regimes constrain the formulation of preferences by actors in a certain area of international relations, as actor expectations converge in a given international relations policy domain.[28] Rosenau introduced a more abstract notion of governance by implying that governance concerns the structuring and ordering of society in the absence of sovereign authority. It functions to prevent violent conflict (a Hobbesian state of nature) and to preserve adequate resources for the continued survival of society's members.[29] A rich literature on institutions is also situated in this second strand of literature (this overlaps with the discussion of Historical Institutionalism and New Institutional Economics below). This entire spectrum of literature points to the importance of rules and regulations ('institutions') shaping actors' behaviour, and allows for both public and private forms of governance.

From this diverse literature it appears that the added value of the theoretical development of the concept of governance is twofold. First and foremost, the contribution of governance studies is that they are not only concerned with rules and regulations emanating from states but also with the role of non-state actors in shaping behaviour. The increasing attention to non-state actors has been variably attributed to the perceived rise in international connectedness, new actors in politics such as (transnational) Civil Society Organisations (CSOs) and business coalitions, and new forms of steering of complex societal problems (e.g. privatisation and New Public Management).[30] In the extreme, this could lead to emerging private patterns of governance where state intervention is virtually absent.[31]

The concept of governance consequently helps us analyse diverse forms of rules and regulations that do not necessarily emanate from states. It could be argued that the concept of governance underscores the nature of IPE: it is not only about power struggles among states, but also about conflicts and cooperation between public and private societal actors pursuing their preferences. In other words, it is about both power struggles between public authorities and the private sector, and within the private sector and public sector itself (e.g. struggles between regional and international banks, or bureaucratic struggles between ministries). Governance as an emerging theoretical concept has thus encouraged a critical rethinking of the relationship between states and markets (or society in general) and of the forms of authority that shape these relationships.

A second added value of the governance concept, which follows from the first, is the attention to (possibly newly emerging) problems of accountability and legitimacy.[32] If we include rules and regulations emanating from non-state actors in our analysis, we can no longer be certain that these forms of governance result from democratic procedures aimed at legitimacy (as we would in the case of rules emanating from governments in established democracies).[33] While, for example, the World Bank reduces its conceptualisation of governance mostly to 'government', its 'good governance' agenda was introduced as a way to focus on issues of accountability and responsiveness to citizens' concerns (about corruption) in developing countries' governments. The issue of legitimacy will not be elaborated here in theoretical terms, but the study will consider both cases under study in relation to issues of legitimacy and accountability (particularly in the concluding chapter).

These two contributions made by the concept of governance to the literature show how it can enrich the analysis of the dynamics of the global financial system, providing a more 'complete' picture. Governance is not a static variable, however; the rules and regulations shaping actors' behaviour are in constant flux as are actor preferences in this regard. This draws attention to the impact of such shifts in governance on the structure of markets and the distribution of resources. The way markets function and distribute resources is very much dependent on the rules and regulations that steer the market participants – rules and regulations that can be enacted by government or private sector associations (and hybrid organisations).[34] Governance is therefore an integral part of what allows markets to function, and the way markets work is part of the pattern of governance.[35]

Disentangling multilevel governance

As the discussion above showed, the conceptualisation of governance applies to a wide range of contexts and on different levels. In this thesis, the focus of analysis is financial governance. The 'financial' part of this concept means, in the words of Susan Strange, that it concerns the (international) system for the allocation of credit.[36] Financial governance is then the

[28] Krasner, 1983.
[29] Rosenau, 1992, p. 3.
[30] Brunnengraeber et al., 2006; Rittberger & Nettesheim (eds), 2008. Whether governance as an empirical phenomenon is really a new response to these developments can be questioned; think, for example, of the governance of private forms of money by medieval merchant networks (Kindleberger, 1993, p. 8).
[31] See, for example, Fransen, forthcoming 2011 for an extensive treatment of private governance regimes in the clothing sector (one of the sectors where private regimes governing labour standards have advanced most). Seminal contributions are Cutler, Haufler & Porter, 1999; and Higgot, Underhill & Bieler, 2000.
[32] Van Kersbergen & van Waarden, 2004, p. 144 and 155 – 160. See the introduction and further contributions to the volume by Underhill, Blom and Mügge, 2010b that analyses the legitimacy issues in global financial governance throughout the volume.
[33] The same would apply if we extent our political economic analysis to states with less clearly established democracies.
[34] Compare, for example, the literature on regulation: Vogel, 1996; Jordana & Levi-Faur, 2004.
[35] Cf. Underhill's state-market condominium conceptualisation, Underhill, 2003 and 2007b.
[36] Strange, 1996. Compare also Allen & Gale, 2001 who conceptualise a financial system as a set of markets for assets and liabilities and the actors (individuals and institutions) who interact on this market.

rules and regulations that steer the behaviour of actors involved in the allocation of credit.[37] Especially after the fall of the Bretton Woods system the internationalisation of the financial system accelerated, giving rise to emerging patterns of 'global financial governance', which refers specifically to the rules and regulations that shape actors' behaviour on (cross-border) financial markets.

The internationalisation of financial markets also led to a shift in attention to the interaction between governance patterns at different levels, or so called multilevel governance. This gives "expression to the idea that there are many interacting authority structures at work in the emergent global political economy," and consequently also includes the notion of public and private authority and their interrelationship.[38] Since the term 'level' is not meant to imply hierarchy, depicting financial governance as multilevel allows for a more subtle distinction than e.g. the national versus the international level. In other words: the global does not necessarily trump the national level, or vice versa.

Shifts in governance may take place from one level to the other. For example, had the Sovereign Debt Restructuring Mechanism of the IMF materialised, the global level would have gained substantially in importance vis-à-vis the domestic level in sovereign debt restructurings. Furthermore, by using the concept of multilevel governance, attention is also extended to levels not easily captured in pure jurisdictional terms, such as advanced 'footloose' or 'virtual' financial markets. The concept of multilevel governance draws our attention to the interaction between these levels, which is one of its main contributions.

The case study descriptions in the Introduction showed that changes in the pattern of governance were not one-dimensional. To gain the full benefit of understanding the interaction between the different levels of governance, however, different shifts in governance that can take place should be disentangled. Lumping different shifts together would lead to fuzzy analysis, as there might be different explanations for different sorts of shifts. Therefore, in this study three dimensions across which shifts in governance may occur are distinguished. First, the level of governance as a matter of jurisdiction, second the nature of the 'owner' of the rules (public versus private) and third the level of stringency (the degree to which the rules constrain the behaviour of actors acting under them). Each of these dimensions helps us understand the forms shifts might take, and taking them together could lead to an improved understanding of shifting patterns of governance. The three dimensions are further elaborated below.

[37] This conceptualisation is based on Germain, 2010, p. 11. It should be noted, however, that he includes an explicit normative element by emphasising that behaviour should be "sound and efficient". He also explicitly mentions the role of norms. In my view, these should also be seen as incorporated in my conceptualisation above (under the rubric of rules).

[38] Baker, Hudson & Woodward, 2005, p. 14. See the edited volume by Baker, Hudson & Woodward for applications of the concept of multilevel governance and the state-market condominium to finance. Hooghe & Marks, 2003 provide a state-based typology of multilevel governance.

The first dimension in the governance of global financial markets concerns the level of governance in a jurisdictional sense, in other words designating in which jurisdiction (or 'level') the rules that shape behaviour are embedded. Shifts across this dimension determine the political community directly affected by the governance pattern.[39] For example, a shift upwards on this dimension means the same rules apply to multiple jurisdictions. On the one hand, this might reduce 'policy space' for actors in one jurisdiction, as the rules emanate from a higher level. On the other hand, it facilitates cross-border activity as the applicable rules are the same. As governance is the outcome of a policymaking process, shifts upwards imply that a policymaking institution or cooperative process at this higher level has facilitated decision-making. This links shifts on this dimension to legitimacy questions: is a shift upwards accompanied by proper representation on the input side? Does the policymaking institution at the higher level include all jurisdictions that adopt the governance pattern? This might not necessarily be the case ex ante: for example, the Basel Capital Accords were adopted by many non-BCBS states.

Although this dimension conceptually includes the subnational level, in this study the jurisdictional dimension extends from the national level upward (subnational financial regulatory units are mentioned in passing if relevant). In other words, shifts in governance along this dimension go from states to groupings of states (either 'international' or regional like the EU) to the global level and vice versa. As the dimensions are continuous, the question can also be how mechanisms of governance are distributed across levels; the CACs, for example, are subject to a global level standard but are implemented nationally. Another aspect of this dimension of governance which comes to the fore in the literature is the question of national distinctiveness versus global convergence, in other words the domestic implementation of international standards.[40] Analytically disentangling these aspects under a first dimension of multilevel governance provides the building blocks for our understanding of state actors in a global financial system.

The second dimension refers to the nature of the authority that implements the rules by which international financial markets are shaped; is this public or private authority (or a mixture of both)? Public authority is responsible for general interests and affairs of the social collective; it is hence associated with citizens and the state. Private authorities are accountable to particular interests (which strictly speaking includes both business and CSOs).[41] This public-private distinction closely corresponds to the state/non-state distinction.[42] This also

[39] Due to economic linkages, shifts in governance in one political community might also indirectly affect other communities, for example when the international level Basel I Accord (implemented in the G10) discouraged investments in non-OECD states. These indirect effects are not taken into account in analysing this dimension.

[40] Walter, 2008 and 2010.

[41] I will pass over the debate to what extent public authorities really succeed in representing the 'general interest'.

[42] Weintraub, 1997, p. 5. The volume edited by Weintraub provides a fundamental treatment of the public-private distinction as the 'grand dichotomy of Western thought'. See also Horwitz, 1982.

implies that 'public' is distinguished by "the use of legitimate coercion and the authoritative direction of collective outcomes."[43] These collective outcomes are supposedly based on the preferences of the whole political community, and not those of particular collectives within that community. There is a continuum ranging from the exertion of public authority in government to governance by private authorities (often entailing private governance or self-regulation), with hybrid forms in between (e.g. public-private partnerships).[44]

Whether the nature of authority is public or private is especially relevant given its implications for legitimacy and accountability. Private authorities usually lack mechanisms for democratic legitimation, nor would such a mechanism be necessary per se (following the reasoning that they work for the benefit of their constituency, e.g. shareholders).[45] However, the costs and externalities generated by private governance may be born by the public, as is often the case with financial crises. Furthermore, shifts across this dimension have implications for the power relations between public and private actors in subsequent policymaking processes. When implementation is delegated to private actors, these gain an information advantage on public actors, increasing the power of these private actors in the policymaking process, for example through agenda control (see also the discussion of the ideational factor in policymaking processes below).

The third dimension of governance is the level of stringency or compellence, indicating to what extent actors are constrained by governance mechanisms. This concerns the leeway actors have to make their own choices in following the aims of the rules, and how rules are ultimately enforced. This dimension is especially important for future developments of and innovations in financial markets – and hence the market structure – as, for example, the development of new financial services might be either forbidden or allowed under more or less stringent regulations. Arguably, this dimension, even more than the others, determines the likelihood that financial instability might affect societies: granting private financial actors more leeway allows them to create greater havoc when things go wrong, just as it might encourage innovation.

Fransen (2011) divides stringency into the scope of the governance pattern, implementation specificity, and control mechanism.[46] The scope variable signifies different elements of the policy domain to which the governance pattern applies. In this thesis, the cases do not vary on the scope variable. However, the latter two elements provide useful tools to operationalise the stringency dimension. The element of implementation specificity is reflected in the field of financial governance in the debate on 'principles-based' versus 'rules-based' prudential regulation.[47]

[43] Weintraub, 1997, p. 36.
[44] Mügge, 2006 provides an interesting argument relating shifts along this dimension to changes in the market structure.
[45] Hence Friedman's famous dictum "the social responsibility of business is to increase its profits" (Friedman, 1970).
[46] Fransen, 2011, chapter 3 develops an index for stringency of private sector self-regulatory labour standards in the clothing industry based on these three elements.
[47] This debate gained traction in the policymaking process just before the crisis broke out. See the speeches by Bernanke (15 May 2007) and McCarthy (13 February 2007).

Principles-based regulation communicates a regulatory aim to market participants while leaving them to find the way to act in accordance with this aim. Rules-based regulatory systems to a much larger extent also determine how to achieve the aim, shaping behaviour of actors more directly. Rules-based governance is consequently more stringent. The element of control mechanisms concerns the actual implementation of the rules or principles and sanctions in case of non-compliance. In a market-based governance pattern this is left to (private) market actors via their transactions, which implies a less stringent governance pattern than one where rules or principles are directly enforced by a 'higher authority'.[48]

To summarise, financial governance refers to the rules and regulations that shape the behaviour of actors on (international) financial markets. By distinguishing these rules and regulations along the three dimensions of level, nature and stringency, the concept of financial governance is clarified and a better analysis of how the patterns of governance have shifted in the issue areas of the cases may be enabled. As the discussion above showed, the different dimensions each shed light on different aspects of the legitimacy of governance patterns. Also, the distributional consequences and the impact of changing governance patterns is highlighted and clarified by unpacking multilevel governance in this manner. Finally, this 'unpacking' of the concept also enables us to theorise more clearly on what causes shifts in governance. The next section takes a first step in this direction.

Institutional approaches to governance

As mentioned above, the concept of governance has roots in a variety of disciplines, which unfortunately also on occasion leads to confusing terminology. For example, an important strand of literature that implicitly explains governance is rooted in Sociology and Economics and discusses institutions.[49] It is this literature that will be used as a starting point towards our explanation of governance. Douglas North's conceptualisation of institutions can serve to illustrate the similarities between the conceptualisation of institutions and governance. As one of the most distinguished new institutional economists, he has defined institutions as "the humanly devised constraints that shape human interaction. In consequence they structure incentives in human exchange."[50] This closely mirrors 'rules and regulations shaping the behaviour of actors.'

[48] See also Treib et al., 2007, p. 5-7 on the elements of stringency.
[49] Note that although the institutional literature fits into the conceptualisation of governance as developed in this thesis, it is likely to overlook the added value of the governance concept that was pointed out above. Especially the issue of legitimacy and accountability is often only dealt with cursorily.
[50] North, 1990, p. 3.

Although there are many 'institutionalisms', the contributions in this field are usually classified as 'historical institutionalism' (HI), 'rational choice institutionalism', 'sociological institutionalism' or the newly emerging 'discursive institutionalism'.[51] Given the focus of this thesis, the discussion below concentrates on historical institutionalism and rational choice institutionalism (more specifically, New Institutional Economics, NIE) as these strands of institutional literature have been most concerned with explanations of institutions focused on respectively the state or the market. Also, interestingly, while one is based in micro foundations (rational choice for NIE) the other is more rooted in macro processes (HI). The role of ideas and discourse, which is a central contribution of discursive institutionalism, will come back in the discussion of the role of ideas in policymaking processes below, as will the social construction of rationality – one of the central tenets of sociological institutionalism.

The different types of institutional literature are not unrelated in conceptual terms and theory development often takes place across the borders between two types. For the sake of exposition, in the discussion below 'hard boundaries' will, however, be drawn around HI and NIE – boundaries that might result more from disciplinary affiliation in Economics or Sociology than actual content of the theories.

Historical Institutionalism

Historical Institutionalism mainly focuses on state institutions and structures.[52] It has therefore been associated with the previous call to 'bring the state back in'.[53] As the name suggests, it studies institutions from a historical perspective, showing the origins and development of institutions and institutional complexes over time. The HI perspective has made important contributions to the 'varieties of capitalism' debate, by showing the historical continuity of the institutional complexes underpinning the varieties of capitalism.[54] The complementarities between institutions which emerge over time lead to different modes of state-market relations, which may all be economically successful. From an evolutionary economics perspective, it has been shown through formal modelling that this leads to stable institutional set-ups (although hybridisation of systems is a possible avenue for change).[55]

Financial globalisation has presented a challenge to the traditionally domestically oriented HI theories.[56] However, HI can be extended to the international level by, for example, allowing the stable domestic institutional set-up to function as an explanatory factor for the preferences and capabilities of state actors in international negotiations. Constituencies are formed for certain state actors, which leads to a 'locking in' of their preferences. In this way, the domestic institutional context determines which actors participate in international negotiations, and what their preferences are.[57]

The HI approach has the added value of relating the interests of actors to the historical development of their institutional context, and showing how path dependency and lock-in effects occur. It is these effects that provide HI with explanatory leverage. In the important contribution of Pierson to this literature, path dependence results from self-reinforcing or positive feedback loops.[58] It makes alternative patterns of governance increasingly costly for actors. This would fit with rational choice institutionalism in the form of NIE discussed below. However, importantly, HI diverges from NIE as path-dependent processes can also follow from, for example, power relations (dominant actors retain their power on a certain path) and legitimacy logics (paths are seen as morally just or appropriate).[59] The existence of path dependencies leads scholars in the HI tradition to search for critical junctures at which the choice between one or the other path was made.

A related form of institutional path dependency is based on reactive sequences. Reactive sequences follow from a key breakpoint in history, and can be logically derived from this breakpoint.[60] These breakpoints usually are what economists would call 'exogenous shocks', and it has been argued that financial crises might function as such breakpoints leading to a response in the form of a new governance pattern.[61] This gives rise to explanations of shifts in governance that are informed by financial crises and the policy reaction to them. Less drastically, the complexity of institutional patterns in globalised financial markets and redundant capacity might offer alternative institutional solutions to emerging problems. This allows actors to 'break the path' in response to changing circumstances without the need for full-blown financial crises.[62]

A problematic aspect of the HI literature, however, is that the interaction between actors, which leads to these path dependencies, is underspecified. As Mahony notes: "most historical sociologists have not specified exactly how a focus on processes, sequences, and temporality underpins path-dependent explanation."[63] It remains an open question for HI theories at which moments actors seek change, and why certain paths are chosen.[64] HI implies a relationship between economic change and shifts in governance, but provides no systematic explanation of this relationship.

Moreover, HI can appear historically determinist: formative moments and issues of timing and sequence set the path after which little agency is left, or at least only at high costs (a

[51] See, for example, Schmidt, 2006.
[52] Schmidt, 2006, p. 104.
[53] Evans et al., 1985.
[54] Hall & Soskice, 2001; Becker, 2009. For an analysis from an Economics perspective, see Allen & Gale, 2001.
[55] Hölzl, 2006.
[56] Hall & Soskice, 2001, p. 64; Deeg & Jackson, 2007, p. 154 – 155.

[57] Farrell & Newman, 2010.
[58] Pierson, 2000, p. 251. See also Mahony, 2000.
[59] See Mahony, 2000, table 1 (p. 517).
[60] Mahony, 2000.
[61] E.g. Bird, 1996.
[62] Crouch & Farrell, 2004.
[63] Mahony, 2000, p. 510.
[64] Deeg & Jackson, 2007, p. 163 – 164. See also Drezner, 2010.

very restricted choice set). Culpepper, for example, notes that legal changes alone do not suffice for real change, but rather a 'joint belief shift' is necessary to drive institutional change.[65] While theories of institutional change have been developed under HI, these also point to the underlying continuity in structures.[66] To these criticisms we return below, after discussing NIE as representative of rational choice institutionalism.

New Institutional Economics

New Institutional Economics is a rational choice institutional perspective associated with the discipline of Economics that addresses questions of governance. When discussing governance from an Economics perspective, as a point of departure it could be noted that in the general equilibrium framework of neoclassical economics, rational actors interacting on the basis of their material interests spawn a spontaneous order that tends towards equilibrium.[67] This does not necessarily means that (financial) markets would be stable, however; exogenous shocks could still cause crises. However, the implication of the general equilibrium framework is that 'governance' can be limited to ensuring property rights (and arguably transparency, although complete information is usually just assumed), which could also be provided through the market mechanism.[68] These theories consequently pay little attention to the interaction between public and private actors, or the role of the state and the preferences of its agencies. Public actors are portrayed as exogenous (a clear dichotomy between states and markets). The empirical relevance of these theories can be doubted: historically there has always been a close relation between the emergence of states and markets.[69]

Although not necessarily inspired by this empirical puzzle of the significance of states in real-world economics, criticism emerged on the general equilibrium framework of neoclassical economics from the 1970s onwards. One set of criticisms focused on the problems of asymmetric information.[70] Information asymmetries arise, for example, in financial markets when the actor demanding funds has more information on the way these funds will be used than the provider of these funds (which is almost by definition the case). For example, a country issues bonds claiming it will invest in its infrastructure and thereby raise its potential economic growth. However, the buyers of the bonds have no way of being certain that the funding provided will not be used instead to satisfy other interests through unproductive government spending (e.g. maintaining a monarchy). Therefore, lenders need to monitor the actions of borrowers to ensure timely repayment and/or borrowers need a credible signal that

[65] Culpepper, 2005.
[66] See Streeck & Thelen, 2005.
[67] See for a criticism of the possibility of attaining general equilibrium Barry-Jones, 1988.
[68] Eggertsson, 1990.
[69] The classic reference for this point is Polanyi, 2001 (1944); contemporary elaborations are provided by Tilly, 1992; Fligstein, 2001; and Schwartz, 2010.
[70] In 2001, Akerlof, Spence and Stiglitz shared the 'Nobel Prize' in Economics for developing the analysis of markets with asymmetric information. For its application to monetary economics, see Stiglitz & Greenwald, 2003. Classic references are Akerlof, 1970 and Spence, 1973.

they are creditworthy. Financial markets especially are prone to information asymmetries, but in general markets almost always exhibit information asymmetries.[71] In case of information asymmetries, interventions in the market exist that would improve efficiency. In other words, there is a theoretical case for governance.

Information asymmetries can lead to transaction costs, as the parties to a transaction spend time and money to reduce the asymmetry (by, for example, signalling of the party with an information advantage or information gathering by the party with an information disadvantage). More generally, when the assumption of full information does not hold up, transaction costs emerge. This offers a second and related micro-level challenge to the neoclassical general equilibrium theory. Transaction costs are "the costs that arise when individuals exchange ownership rights to economic assets and enforce their exclusive rights."[72] This could, for example, be the time and resources spent gathering information about competing offers, but also the drafting of contracts and the enforcement of such contracts.

These insights into the functioning of the market and their relation to governance patterns were generalised in what has become known as New Institutional Economics. This bundle of literature builds on neoclassical economics by taking transaction costs into account, yet stays within the rational choice framework to explain the emergence of institutions and organisational patterns ('governance' in terms of this thesis) as part of how economies and markets work.[73] An important point is that institutions structure incentives (i.e. perceived material interests) in human exchange.

NIE points to transaction costs as the explanatory factor for the emergence of private actors such as financial intermediaries,[74] but also public institutions such as property rights. NIE shows how actors reduce transaction costs by collectively developing institutions that enforce property rights. These institutions are needed to reduce transaction costs and thus to make well-functioning markets possible. The existence of transaction costs consequently provides a functional need for governance mechanisms to ensure that (financial) markets function.

However, unlike the situation implied by neoclassical economics, the institutions need not be socially optimal or efficient.[75] North makes the distinction between institutions (the rules) and organisations, which try to maximise their utility within the constraints of the current set of rules.[76] This links to the literature on rent seeking, where organisations try to

[71] Stiglitz, 2001.
[72] Eggertsson, 1990, p. 14.
[73] The seminal reference is North, 1990. See also Eggertsson, 1990. Eggertsson makes a distinction between neo-institutional economics (which leaves rational choice assumptions intact) and new institutional economics (which uses bounded rationality assumptions like satisficing). This distinction does not seem to be used consistently in the literature, and here both types of institutional economics are referred to as New Institutional Economics.
[74] A classic reference is Williamson, 1975.
[75] Acemoglu, 2003.
[76] North, 1990, p. 7.

increase their utility by maintaining the current set of rules.[77] This creates lock-in effects and path dependency, allowing this theory of governance and institutional change to account for the continuing existence of inefficient institutions in a rational choice framework. Governance is integral to why some markets work better than others; it is consequently the relation between governance and the market that is important.[78] We will return to this point below in the discussion of the relation between market structures and governance patterns.

Although this literature provides a clear explanation of the *functional* need for governance, and provides a motivation and idea of preferences in relation to the interaction of material interests, it provides fewer clues as to how the specific shifts along the dimensions occur. It mainly accounts for *why* governance should be there, without showing *how* or *what sort* of governance emerges. As Eggertsson states, "rational individuals will compete not only to maximize their utility within a given set of rules, but also seek to change the rules and achieve more favourable outcomes than was possible under the old regime."[79] How this rule change comes to be, in other words the application of NIE to policymaking processes, is underdeveloped.[80] A functionalist assumption of efficient policymaking processes seems, at best, to hold sway – provided decisions are not just assumed to emerge as manna from heaven. Eggertsson rightly acknowledges that consistent implementation of NIE would also extend to policymaking processes.[81] North has argued that a successful theory of institutional change requires both a theory of the state as the main policymaking actor and theories of ideological behaviour.[82] This criticism coincides with the aforementioned criticism on HI that it underspecifies how the process of path dependence or a breakthrough actually works. At what point do actors collude in choosing a new departure indicating a shift in governance?

A first step in addressing some of these challenges to NIE has been taken by Acemoglu, Johnson & Robinson (2004). They propose a model where political institutions and the distribution of resources lead to political power that translates into changes in economic and political institutions. These changes influence subsequent economic performance, and (crucially) the distribution of resources. In other words, the distribution of resources (market structure) leads to changes in governance (economic institutions), which feeds back into the market structure. The account of Acemoglu, Johnson & Robinson of the policymaking process is still rudimentary, however (as will be elaborated below, they give scant attention to some of the central explanatory factors for policymaking processes coming out of the literature; attention to the role of ideas is minimal, for example). More importantly, their model is oriented at the domestic level and it is unclear how it would extend to the international level (in other words, how it would function in a multilevel governance framework).

77 Krueger, 1974. See further below.
78 Acemoglu, Johnson & Robinson, 2004.
79 Eggertsson, 1990, p. 13.
80 See Acemoglu, 2003 and Acemoglu, Johnson & Robinson, 2004.
81 Eggertsson, 1990.
82 North, 1981, chapter 6. North also points to the need of theories of demography and technological change.

To summarise, both HI and NIE predict institutional stability (an issue to which we will return below). This stability seems only to be punctuated by exogenous shocks, leading to a crisis-driven explanation for shifting patterns of governance. Furthermore, both bundles of literature underspecify how the policymaking process leading to institutions can be characterised. There is therefore an explicit need for interdisciplinary tools for analysing the policymaking process. We can turn to the insights of the Political Science and Political Economy literature to shed light on this second problem. By examining how policymaking processes actually work in a context of power relations and political constraints we can get a better understanding of which institutions actually emerge under HI or NIE. In other words, to explain governance (output side) we also have to look at the input side, the policymaking process that leads to decisions that yield inertia or change. To this we turn in the next section.

Analysing the policymaking process

The literature on policy networks and policy communities is a useful point of departure to address the extensive literature on policymaking processes.[83] Given the relevance of patterns of governance for socio-economic outcomes, there is a wide variety of demands on the policymaking process leading to a governance pattern. This wide variety of preferences and the degree and pattern of interaction among the actors holding them constitutes the policy network. Policy networks emerge around specific policy domains (in this thesis, bank capital adequacy and sovereign debt crisis resolution). Within the policy network groups can emerge whose members have a strong level of shared beliefs, values and interests to the extent that they share preferences. These groups often provide a framework for political action as advocacy coalitions.[84] More importantly, in the policy network, there is a specific subset of actors who can reach authoritative decisions: the policy community.

Although the literature on policy networks and communities offers a useful categorisation to apply to policymaking processes, it offers less insight into the actual content of the policymaking process and how it can be explained. Plotting out the different actors and their relations does not automatically lead to an explanation of the process that emerges when they start interacting.

In the 'open range'[85] of (International) Political Economy, much work has been done which offers an in-depth analysis of this interaction in the policymaking process. These theories range from public choice approaches (basically applying the lessons of neoclassical economics to political processes) to poststructuralist approaches focusing on the social construction of

83 For the conceptual confusion in the policy networks and policy communities literature, see Atkinson & Coleman, 1992, p. 158. See also Coleman & Skogstad, 1990; Dowding, 1995; and Coleman & Perl, 1999.
84 Sabatier, 1988.
85 Strange, 1984, p. ix.

identities and ideologies. Three key factors have emerged in the literature with respect to the interaction in and outcome of policymaking processes: material interests, ideas and institutions.[86] Different approaches have each emphasised different factors, conceptualised them differently and theorised different relations between them. Moreover, different approaches focus on one or both of two steps in policymaking: firstly the formation of actor preferences, and secondly the interaction among actors. This section discusses the different factors, and also shows the weaknesses of focusing on any one of them exclusively.

Material interests

The literature seeking to explain the outcome of policymaking processes as a function of (material) interests is often identified as part of the rational choice tradition. In line with the steps in policymaking introduced above, two issues are at stake: first, how to conceptualise material interests and the resulting preferences of actors; and second, how to aggregate the preferences during the interaction in the policymaking process into formal explanations of the outcome. In the discussion below we start with approaches developed out of the Economics discipline.

The public choice approach is an important bundle of literature explaining policymaking processes from a material interest perspective.[87] These apply the neoclassical insights to politics. An important contribution to this literature was made by Anne Krueger with the introduction of the notion of rent seeking.[88] Rent seeking occurs when market actors seek regulations not to solve market failures, but to protect and enhance their interests. An example is when incumbent banks lobby to limit the number of new banking licences granted by financial authorities. This does not solve a market failure, but serves to limit competitive pressures on these banks and hence increases their profit-making potential, in line with Adam Smith's statement: "widen the market, narrow the competition."[89]

It has been argued that Marxist economics is interest-based too.[90] In this strand of theory, it is not so much individual actors satisfying their interests, but rather their aggregates into classes. The class struggle concerns the division of the social product, with each class – or fraction thereof – trying to maximise its share (or in the case of labour: minimise the extraction of social surplus).[91] Both public choice and Marxist-oriented approaches consequently

[86] Interests, ideas and institutions is the usual parlance to refer to the debates surrounding these explanatory factors in policymaking processes. As will become clear from the discussion below, different approaches sometimes use slightly different terms for the factors; more importantly, however, institutions here refers to policymaking institutions, or in the words of Eggertsson: "formal political and organizational practices" (Eggertsson, 1990, p. 70).
[87] For an overview, see Mueller, 2003.
[88] Krueger, 1974. Anne Krueger later became the First Deputy Managing Director of the IMF and championed the Sovereign Debt Restructuring Mechanism.
[89] Smith, 1991 (1776), p. 232.
[90] Mandel, 1990.
[91] Mandel, 1990, p. 8.

assume rational actors maximising their utility (usually measured as – monetary – gain or 'accumulation').

There are several problems with the utility-maximising, interest-based approach. First, it is debatable whether market actors are indeed in cut-throat competition to maximise utility, as the public choice theorists assume. Rather, as sociological institutionalists argue, market actors seem to focus on the creation of stable social 'fields'. As Fligstein points out, "The sociology of markets that I am developing replaces profit-maximizing actors with people who are trying to promote the survival of their firm."[92] This view links to the recent insights of North on the role of uncertainty (as opposed to risk) in economic change.[93] At a general level, these insights imply that agents seek control over their environment, reducing uncertainty. Firms do this by building an efficient internal organisation in order to compete with rivals, but also by employing political resources via policy rent seeking. Even where they are aware they will likely not succeed in eliminating competition, they seek to limit competition to what they know, i.e. to companies doing things the same way they do. One way to avoid or reduce competition is by market segmentation.[94] Firms seek to eliminate the uncertainty of radical innovations, new entrants, etc.; in other words they seek to define the terms of competition – what Fligstein calls a 'stable conception of control'.[95]

This sociological conceptualisation of markets leads to a more subtle understanding of what actors' interests actually might be, instead of the one-dimensional view of profit-maximising actors. This diversity of interests is further compounded by the emergence of different types of actors in the policymaking process. CSOs are active in economic governance at both the national and international level. For example, Third World Debt Cancellation advocacy groups have been involved in the sovereign debt restructuring case. When the market is international (and market failures are consequently also internationalised) this furthermore requires extending the public choice approach to the international level. This brings into play state actors negotiating in international policymaking institutions.[96]

The link between the material interests of market actors and the interests of states in international negotiations has been modelled as a two-level game.[97] In this two-level game, state agents try to find a balance between the demands of international negotiations to come to an agreement and satisfy the interests of domestic constituencies (which might be engaged in policy rent seeking).[98] On the one hand, this set-up makes it likely that state interests in international negotiations on global financial governance are closely associated with the interest

[92] Fligstein, 2001, p. 17. It might be noted that Fligstein's analysis of the threats to survival of firms is consistent with Porter's conceptualisation of the market structure which was introduced above.
[93] North, 2005.
[94] Fligstein, 2001, p. 5.
[95] Fligstein, 2001, p. 22.
[96] Besides opening up a whole new bag of potential market failures, coordination problems, etc.; see Kaul, 2008.
[97] Putnam, 1988.
[98] See Underhill, 1997 for country studies in the field of finance showing some of these dynamics.

of the domestic financial community. On the other hand, it also gives public actors an independent and powerful agency as the 'spider in the web'.[99] Next to market actors seeking stability or utility maximisation, public actors also have their own material interests which can be broader than just solving market failures or maximising national economic welfare.[100]

How to aggregate this diversity of material interests in the policymaking process is a problem for public choice approaches. A simple utility maximisation exercise – implicitly based on the same assumptions as the general equilibrium theory discussed above – will no longer do. First of all, it has to be empirically established which actors are 'only' part of the policy network and which are also part of the policy community. Without an account of the institutions of policymaking and the actors involved, we cannot account for the resulting governance pattern. In other words, we need to analyse how the policymaking institutions on which the policy community is based function, and how they relate to the wider network.

Next to this 'static' argument for extending our analysis from solely material interests to policymaking institutions as well, there is also a 'dynamic' argument. The public choice approaches mentioned above suffer from an ahistorical and uncontextualised conceptualisation of material interest. When we look at firms as agents, for example, it can be shown that their driving motive has significantly changed over the decades: from profit maximisation to shareholder value maximisation.[101] Similarly, Cerny has argued that the definition of the interests by state actors has changed from the welfare state to the 'competition state' admitting that the nature of states and their interests are dynamic.[102] When we want to account for shifting patterns of governance, we consequently need to analyse the development of revealed preferences of the actors over time, instead of ex ante determined interests. If we want to know why actors make decisions as they do, material interests should be empirically derived, not a priori assumed.

Furthermore, it should be noted that – as mentioned above – there is no clear ex ante public interest or private interest in the abstract. Public actors are active in credit markets on the demand side and private actors exert authority; their material interests are consequently multifaceted. In developing their preferences, actors simultaneously consider the dynamics of market competition and those of governance patterns.

This endogenous nature of preferences points to the relevance of policymaking institutions (as also mentioned above) and ideas, which might influence the formation of these preferences and the context in which some can realise preferences more readily than others. Material interests cannot serve as an explanation for the outcome of the policymaking process without taking these other factors into account. Before elaborating on the explanatory power of policymaking institutions in policymaking processes, the next section discusses the factor

[99] Cerny, 2005.
[100] See, for example, the debate on office-seeking or policy-seeking political actors, Müller & Strøm, 1999.
[101] Rappaport, 1998; Horn, forthcoming 2011.
[102] Cerny, 1997.

of 'ideas', as the societal embeddedness of actors points to the possible influence of idea-sets on perceived material interests and hence revealed preferences.

Ideas

Several approaches consider ideas in one form or another as a main explanatory factor in policymaking processes. Especially the field of financial governance has been influenced by this approach, given the performativity of finance theory and the reflexive nature of financial markets.[103] As mentioned above, there is an important link between ideas and the formulation of preferences. This also relates to the role of experts in policymaking (as actors expressing preferences), which is often intermingled with analysing the role of ideas in policymaking. [104] Ideas can also play a role in the second step of policymaking (after preference formation): explaining the interaction in the policymaking process. However, the role of ideas in this second step of the policymaking process is hard to distinguish from the role of agents and policymaking institutions in which ideas find expression, and a number of approaches that could also be labelled 'ideational' are therefore discussed in the next subsection on institutions.

In the epistemic communities approach, the explanatory power of ideas is on the one hand portrayed as an almost 'exogenous' force in the policymaking process. Epistemic communities are national or transnational communities of experts who have reached a consensus in a particular policy field and push this consensus on the policy agenda (they consequently express a preference for a certain policy). It could even be said that in this case ideas obtain an agent-like quality in the policymaking process in the sense of a consensus reached by an expert community.[105]

On the other hand, as Adler & Haas point out, epistemic communities do "narrow the range within which political bargains can be struck."[106] This indicates the influence they can have on the interaction in the policymaking process. These explanations are therefore not based on either market or state actors, as was the case with the interest-driven explanations discussed above. To illustrate, it could be argued that the G30's push for the renegotiation of Basel I was the work of an epistemic community, although the inclusion of active policymakers in the G30 means that it does not adhere to the strictest definition.

[103] For an elaboration of reflexivity in financial markets, see Soros, 1998; and see Velthuis & Noordegraaf-Eelens, 2009 for a discussion of performativity in the context of the current financial crisis. Poststructuralist IPE awards an even more prominent place to ideas by pointing out that the financial system, and hence also its governance, is the result of historically contingent social and discursive practices (e.g. Dodd, 1994; De Goede, 2003 and 2005). It can be doubted, however, whether the insights of poststructuralists add analytical leverage to the puzzle addressed in this thesis. This literature tells us little about how actors, who most likely do not share the deeply critical attitude of the poststructuralists but rather work in their daily 'reality' and are held accountable for their concrete actions, interact to bring about shifting governance patterns. Without a more extensive focus on the agents promoting certain conceptualisations of finance, the poststructuralists see their discursive power struggle in an ideational realm, which is in the end devoid of practical meaning.
[104] See also the discussion of Horn, 2009.
[105] Haas, 1992. For an application to financial governance in the context of the EMU, see Verdun, 1999.
[106] Adler & Haas, 1992, p. 378.

The epistemic communities approach, however, seems not to acknowledge that there might actually be competition between different expert groups with different solutions, nor that the eventual selection of outcomes is unlikely to be disinterested. This seems to suggest that the knowledge is apolitical and not linked to material interests, which is clearly not the case. Expert groups often have internal conflicts and represent different parties in the process. As a source of explanations for the outcomes of policymaking processes, the epistemic communities approach is consequently rather shallow. It could explain them as the result of expert consensus, but that only begs the question how this consensus emerged to dominate the policymaking process given the contested nature of financial governance: who chose the experts from the available community of experts? Verdun nuanced this apolitical nature of the epistemic community somewhat by pointing out that "the notion of an 'epistemic community' requires the members to have a commitment to a political goal and to interpret their knowledge in such a way that it supports their goal."[107] However, having a political agenda still does not tell us which ideas developed into the epistemic community's consensus and why.

In an influential contribution to the debate, Goldstein & Keohane posit three types of ideas: world views, principled beliefs and causal beliefs. These beliefs have an influence on both steps in policymaking. They can serve as an explanatory factor for preference formulation because they provide roadmaps for actors regarding their goals or ends-means relationships and by guiding decision-making in the face of multiple equilibria. They furthermore serve as an explanatory factor in the policymaking process by becoming embedded in political institutions (e.g. administrative procedures of policymaking institutions).[108]

Ikenberry (1992) has overcome several of the strictures of the 'pure' epistemic community approach by showing how ideas can become embedded in political institutions. He focuses less on the consensus with respect to the political agenda, and more on a common problem definition and yardstick against which to measure solutions as the source of the influence of expert groups on the policymaking process. This ideational factor consequently provides an explanation mostly oriented at the interaction in the policymaking process.[109] Having a common problem definition and yardstick shapes discussions in the policymaking process (e.g. by excluding courses of action that the yardstick does not measure).

While ideas are clearly important for a valid account, a drawback of the use of ideas as the main explanatory factor is that it offers few clues on how ideas lead to certain shifts in governance and why actors select the ideas that they do. Why did the G30 and the IIF lobby for a revision of the Basel I Accord towards Basel II based on risk-weighted capital standards via internal risk management models? Why did the idea of a global level solution to the problems of banking supervision (as opposed to national level supervision) emerge in the first place? Focusing too strongly on ideas as the only relevant factor runs the risk of providing an apolitical analysis of political issues. As Cox famously pointed out: "theory is always for someone, and for some purpose."[110]

The ideas dominating the policymaking process should therefore be seen in relation to the preferences (interests) of actors propagating them. The role of ideas should be politicised in the sense that the selection of people involved in expert groups can co-determine the outcome of the discussions. It also seems that the expert consensus only occurs after the policymakers have started participating in the negotiations, suggesting policymaking institutions are relevant as an explanation as well. These will be discussed in the following section.

Institutions

The discussion of the other two factors above has already hinted at the importance of institutions in the policymaking process. The policy community is typically embedded in certain policymaking institutions, like in our cases the IMFC, G7 or the Basel Committee. Interaction of actors within such institutions can serve as an explanation for the outcome of the policymaking process in several ways, but first it should be underscored that these institutions are of a different type than those of HI and NIE. Institutions here concern the "political and organizational practices"[111] specifically pertaining to policymaking processes, and are hence more narrowly confined than institutions as 'the humanly devised constraints on actor behaviour.'

Policymaking institutions influence the first step in the policymaking process (preference formation) in a number of ways that are closely related to the interaction within the institution. They can serve as an explanation for actors' preferences through processes of groupthink and skewed argument pools that occur during the interaction in the policymaking process. With respect to the second step (interaction in the policymaking process), it could be argued that policymaking institutions might influence the interaction in the process due to their exclusionary nature and internal decision-making procedures (such as voting weights). Institutions provide advantages for specific sets of actors, shaping power relations and patterns of inclusion and exclusions. The aforementioned shows, however, that the two steps in policy-making are hard to separate in the case of policymaking institutions. For example, the exclusionary nature of a policymaking institution logically precedes the development of groupthink or skewed argument pools. That being said, the various ways in which institutions factor in policymaking processes are elaborated below.

Sociological approaches to negotiations in the policymaking process have shown that the interaction of policymakers within policymaking institution influences preference formation

107 Verdun, 1999, p. 320.
108 Goldstein & Keohane, 1993. See also Blyth, 2002a and 2002b.
109 Ikenberry, 1992.

110 Cox, 1981, p. 128.
111 Eggertsson, 1990, p. 70.

and articulation through groupthink. When a small group of (in our case) elites interact on a regular basis, it has been shown that individuals fear to dissent from the general thrust of the argumentation.[112] The expression of preferences hence is shaped by the deliberation in a policymaking institution. For example, once a certain 'yardstick' for proposed solutions is agreed on, the discussion of solutions excluded by this yardstick becomes hampered.[113] In itself, however, groupthink tells us little about which specific consensus preference emerges from a group, which brings us to the role of skewed argument pools.

In restricted groups, the argument pools (which form the basis of groupthink) might become skewed. Not all arguments for and against certain solutions are weighted equally, or even weighted at all.[114] When argument pools are skewed, the range of policy options considered narrows. Both groupthink and skewed argument pools are more likely to occur in exclusionary 'clubs', where membership is, for example, selected on the basis of a common professional background. Baker argues persuasively how these different effects occur in the case of the finance ministers and central bank governors of the G7.[115]

As mentioned, prior to the emergence of groupthink or skewed argument pools, certain groups of actors (and their preferences) are often excluded from policymaking institutions. By insulating policymakers from other demands, policymaking institutions narrow the range of policy options.[116] Being granted access to 'club-like' policymaking institutions is therefore crucial for actors if they want to satisfy their preferences (reversely, keeping actors with diverging interests out of the policymaking institutions is one of the most effective ways of improving the chances of getting one's own preferences satisfied and is therefore an important part of the political struggle concerning global financial governance). Being able to embed the policymaking process in an exclusionary policymaking institution gives structural power to those able to do it.[117] This structural power can be enhanced by decision-making procedures that favour certain preferences. This is obviously the case with different voting weights, but also for example the IMF Executive Board's habit of making consensual decisions creates a structural bias against radical change.

However, similar to the other factors mentioned above, institutions can only account for shifts in governance in combination with the other factors (interests and ideas). Policymaking institutions are relevant in that they might shape and bias the policymaking process, but they might only partially account for the preferences that form the actual inputs into the

[112] The classic reference is Janis, 1972 who examined several 'war-and-peace' decisions of the US. Baker, 2006 and 2010 has applied these arguments in his analysis of global financial governance.
[113] Cf. Ikenberry, 1992.
[114] See Sunstein, 2002 on skewed argument pools.
[115] Baker, 2006.
[116] Martin, 1977 argues that insulation from popular demands of capitalist industrialising elites in policymaking institutions (the 'political structure') is crucial for the onset of industrialisation, and subsequently the political structure continues to limit the range of possible economic development strategies through this insulation.

policymaking process. In short, integrated accounts of all three factors should be developed to gain leverage over the dynamics of policymaking processes.

An integrated account of the policymaking process

In other words, as the discussion of the three factors above has underscored, analytical leverage is gained less by looking at any one of them in isolation than by linking them in an integrated account of the policymaking process. Each factor on its own underspecifies the actual agency and dynamics in policymaking processes. There are drawbacks to the emphasis on any one of the factors, and these drawbacks are usually linked to the exclusion of the other factors. In short, more theoretical leverage can be achieved if we combine the three factors in a coherent framework that links preferences and behaviour of actors with their interaction in markets and in policymaking processes, leading to collective institutionalised outcomes. There are too many linkages between the three to render explanations focused on any one of the three particularly useful. For example: it needs to be understood how policymaking institutions might lead to the adoption of certain idea sets; it needs to be understood how idea sets influence the preferences actors adopt; and we need to know how policymaking institutions constrain some actors and facilitate the expression of preferences of others.

Gramsci and his later followers in the neo-Gramscian tradition can serve as a source of inspiration for such an integrated account.[118] This bundle of literature provides a fully integrated and coherent perspective on the relationships of the three factors playing a role in explaining shifting patterns of governance, and hence overcomes many of the drawbacks mentioned above. The concept of hegemony has a central position in the neo-Gramscian approaches, and "appears as an expression of broadly based consent, manifested in the acceptance of ideas and supported by material resources and institutions."[119]

Turning to the three factors central in this section, the material interests of the different actors in the Gramscian model follow from their position in the social relations of production. In other words, the material interests are largely determined by the position in the class structure derived from a specific historical mode of production. However, the innovation of Gramscian approaches over more traditional Marxist approaches was that it is more agent-centric. A dichotomous view of capitalists versus labour is nuanced by fractions of capital and a variety of actors in different coexisting modes of production. Hegemony, as a product of dominant ideas and interests, could be achieved by a compromise among a number of these collective actors. As an example, the implementation of Basel II in the European Union was pushed by a coalition of banks with a transatlantic orientation in concert with public actors in favour of further European integration. As a neo-Gramscian account of the Basel II policymaking

[117] See Strange, 1988 on structural power.
[118] See for prominent examples Gill, 1993 and Cox, 1987. For an application to financial governance, see Soederberg, 2004.
[119] Bieler & Morton, 2004.

process argues, this coalition overcame opposing interest from other fractions of capital.[120]

The second factor (ideas) is integrated in the neo-Gramscian framework through the role of organic intellectuals, who are interlinked with material capabilities and institutions.[121] These organic intellectuals play an important role in the shaping of ideology in support of the specific historic bloc or 'hegemony' of which they are part, which subsequently can shape the preferences of important actors, as happened in the shift from Bretton Woods to a more liberal financial order, for example.[122] This approach has the clear benefit of immediately embedding the ideational factor in wider societal forces, and hence offers better clues as to how a certain expert consensus can emerge.

The third of our explanatory factors (institutions) is a central element in stabilising a particular order. In Cox's conceptualisation, institutions are an amalgam of ideas and material interests.[123] Institutions facilitate negotiation between labour and capital.[124] This implies that they are policymaking institutions, with accompanying rules and procedures.

The neo-Gramscian literature consequently combines the three factors characterising policymaking processes to offer an explanation of shifting patterns of governance. It shows how shifts in governance would most likely be biased in favour of the coalition that maintains hegemony through material capabilities, ideas and accompanying institutions. In a seminal contribution by Cox, this approach was extended to the international system.[125]

A drawback of this bundle of literature, however, is that it runs the risk of overemphasising the social relations of production as the determinant of interests (and hence reducing preferences to broader class relations).[126] At its crudest, such an economism is just as vulnerable as public choice approaches to the criticism of an uncontextualised derivation of abstract interests mentioned above. Furthermore, meticulously carving up classes into fractions of capital begs the question whether it would not be more useful to start our analysis from the actors and their perceived interests and move upwards from there.[127] Some sets of actors are clearly more successful in organizing collectively and articulating their interests.

The hegemony of a certain fraction of capital might account for the fact that all regulatory proposals are biased in its favour; however, that still leaves the question why one specific regulatory proposal is chosen from a range of possibilities. What influence does the policymaking process and the institutions actually have on the outcome? Many of the actual political struggles over market regulation – with important consequences for groups of citizens - run the risk of being underestimated in a neo-Gramscian analysis. While this approach might be useful for analysing the grand thrusts of capitalism, it is more difficult to link it to actor-level empirical phenomena. In light of these drawbacks it seems preferable to look at the revealed preferences of actors in the policymaking process, and empirically derive their preferences instead of building our theories from the abstraction of dialectical relations between labour and capital and carving up these abstractions into actors with explanatory power. In short, neo-Gramscian approaches have managed to integrate the three explanatory factors, but in the process sacrificed attention to a range of interesting and important empirical phenomena.

This brings us back to the question how to combine the three explanatory factors in a coherent framework so as to maximise theoretical leverage that can be brought to bear on shifts in governance. We should first of all note that the material interests of the actors should be empirically derived through revealed preferences, as they are not constant. The interests of private actors (and public actors as well) are, for example, dependent on the specific market structure in which they operate and the competitive pressures it entails. There is no clear ex ante 'public interest' for state actors and not even a clear 'private interest' for private actors. Moreover, the position actors have and the way they interpret this material interest is based on the specific context or role actors play in policymaking institutions.

Different actors with different revealed preferences meet each other in policymaking institutions that are at least partially exclusionary. These institutions therefore play a role in shaping the process. However, the interaction within the policymaking institutions also feeds back into the preferences of actors: groupthink and skewed argument pools might shape their preferences. The policy community dealing with global financial governance is presented as an expert group, entrenching the notion that financial governance is technocratic and best left to independent institutions (e.g. central banks for monetary policy). This can lead to the de facto exclusion of actors from the policy community. If the group of experts establish a common problem definition that comes to dominate the policy community, this can narrow the range of possible developments regarding global financial governance because policy solutions that do not fit their problem definition and 'yardstick' are not seriously considered.[128] It is not without reason that many central banks have extensive research divisions and that private firms commission academic research or bundle their resources in the research divisions of business associations. In this way, a link emerges between certain material interests that use ideas to exclude other interests from the crucial policymaking institutions of the policy community.

As mentioned above, this link is reciprocal, however. A narrow policy community can influence the problem definition and yardstick by not allowing for extensive deliberation, but instead basing decisions on a skewed argument pool.[129] The articulation of preferences by actors becomes bound by groupthink and skewed argument pools, and while actors in the policymaking process

[120] Bieling & Jäger, 2009.
[121] Vacca, 1982.
[122] Gill & Law, 1993.
[123] Cox, 1981, p. 136.
[124] Cox, 1987, p. 26 - 28.
[125] Cox, 1987.
[126] Gamble, 1999, p. 143.
[127] See for a critique of 'fractionalising' classes: Clarke, 1978.
[128] As elaborated by Ikenberry, 1992.
[129] Baker, 2010.

can get their preferences satisfied by ‘doing the intellectual work’, this intellectual work also narrows the range of discussions and hence possible preferences being articulated.

We consequently have a model of the policymaking process where policymaking institutions and ideas play a constitutive role in shaping preferences, while vice versa preferences also play a role in determining the policymaking institutions that house the policy community and the ideas that get expressed in the process. To account for the policymaking process leading to shifting patterns of governance, we have to understand this interdependent dynamic between ideas, institutions and interests.

This model of the policymaking process leaves us with the question what the relation between the policymaking process and shifting patterns of governance and changing market structures might be. The next section will elaborate on this relation and builds towards a simultaneous explanation of shifts in governance patterns and changing market structures.

Addressing market structures and governance simultaneously

The previous section discussed the theoretical literature on policymaking processes in order to address the underspecification of this process in both Historical Institutionalism and New Institutional Economics. Inter alia both HI and NIE take a functionalist approach to policymaking (assuming stable preferences). However, as the discussion of policymaking processes above showed, there are feedback loops in the policymaking process itself that can shape preferences in important ways.

Building on the HI and NIE approaches with a model of the policymaking process does not necessarily address the drawback that both HI and NIE ultimately predict stability in the social world. An ossification of governance patterns takes place through various forms of path dependency, leading to the continued existence of distinct varieties of capitalism in globalised markets, for example. Olson has gone as far as to argue that this ossification of inefficient governance patterns inevitably leads to economic stagnation.[130] Change could result from ‘breakpoints’, for example as a consequence of financial crises. It follows that these theories address with difficulty continuous *shifts* in governance along our dimensions (as these would be rare).

Empirically, however, this stability cannot be found. There is a continuous dynamic of shifting patterns of governance in the global financial system, as well as changing market structures (as the preliminary discussion of the case studies has demonstrated). Shifts in governance along the three dimensions occur almost constantly in apparent relation to changes in the market, which is similarly also dynamic. Only by going into the extreme abstract (‘some form of property rights’ or ‘some form of bank regulation’) can we argue that there is stability

[130] Olson, 1982.

over time. However, in doing so sight is lost of changes on a less abstract level – changes which have important distributional (and hence political) consequences.

It will be argued in this section that the solution of this empirical challenge to HI and NIE lies in a different conceptualisation of the relation between states and markets. By simultaneously analysing developments in governance patterns and in market structures, it becomes clear that it are not so much financial crises that are the drivers of (fundamental) shifts in governance patterns, but that these crises are rather an expression of changes in market structures that drive shifts in governance. In elaborating this point, and in combination with the conceptualisation of the policymaking process above, the theoretical approach of this thesis is developed explaining the developments in the global financial system both on the front of governance and on the front of market structures.

NIE acknowledges that markets cannot function without (state) institutions or ‘governance’. It explains the emergence of this pattern of governance as the result of market interaction, yet at the same time it seems that there is still a dichotomy between markets and states, with markets somehow emerging after which states are necessary to reduce transaction costs. It therefore fails to account for the apparent link between changes in market structures and shifts in governance patterns.

To push this argument further: many explanations of the dynamics of the global financial system portray political institutions (mistakenly) as an external intervention into market dynamics. There is an inherent notion of a dichotomy of states and markets. This dichotomous view of states and markets is reinforced by the separation of the disciplines of Economics and Political Science. To make a crude generalisation: it appears that Political Science has a bias towards states and government, seeing political economy from the perspective of the state, while Economics on the other hand has a bias towards private actors and market transactions, building theories about political economy from the perspective of the market. Empirically, however, market processes and public political authorities are never found apart.[131] The dichotomous view of states and markets hence makes no empirical sense.

Even as an analytical distinction, the state-market dichotomy blinds us to the ways in which states are active constituents of the market, and the ways in which market actors and their constituencies are part of the decision-making on and implementation of governance patterns.[132] The optimal form and level of governance may prove politically and socially unworkable, and the actual form and level of governance will not necessarily be determined by considerations of market efficiency. Within the policymaking process in which the governance of the global financial system is discussed, the central goal of the participants is not so much an optimal international allocation of resources as it is to further the (economic) interests of certain specific constituencies. To explain the dynamics of global financial governance,

[131] See e.g. Tilly, 1992; Fligstein, 2001; and Schwartz, 2010.
[132] Underhill, 2007b.

we should consequently look to explain the interrelated dynamics of changes in market structures and the political interactions constituting these markets.

What is often missing is the acknowledgement that actors (public and private) are simultaneously active in the market and in the policymaking process determining governance patterns. For private actors, the political and regulatory process at the (inter)national level is as much part of business strategies as is investment and marketing.[133] Assuming that the process of competition is somehow separate from the deployment of political resources by firms is empirically incorrect. Private actors themselves are not only interested in successful competition, but also in governance patterns that are beneficial to them. Krueger's original notion of rent seeking was mostly associated with developing countries' politics, as these supposedly had higher levels of political intervention in markets opening up possibilities for rent seeking.[134] However, there is no reason to assume that it is a phenomenon peculiar to developing countries. Firms simultaneously deploy their political and competitive resources to affect the pattern of competition, e.g. by establishing a favourable regulatory framework. This is captured by the wider notion of 'policy rent seeking' to express that firms across all markets seek to further their interests through lobbying for policies that favour their competitive position.[135]

On the other hand, while public actors play an important role in the regulation of the global financial system, they are at the same time active as market participants (e.g. sourcing their financing needs from private financial institutions). Developments in the market structure (e.g. as a result of regulation) are consequently a prime concern for public authorities to ensure future funding on competitive terms. We should therefore not make a sharp distinction between interaction on markets leading to changing market structures and political action in policymaking processes leading to shifting patterns of governance. The actors are the same and their preferences are derived symbiotically from both market and political interaction.

In short, the dichotomous view of states and markets fails to elucidate the relationship between market structures and patterns of governance that is observable in the process of globalisation. The political dynamics in the policymaking process should be integrated into the notion of what a market is, together forming the (global) financial system. The policymaking process functions as the bridge between changes in market structures and shifting patterns of governance, creating a persistent feedback loop from shifting patterns of governance to changing market structures.

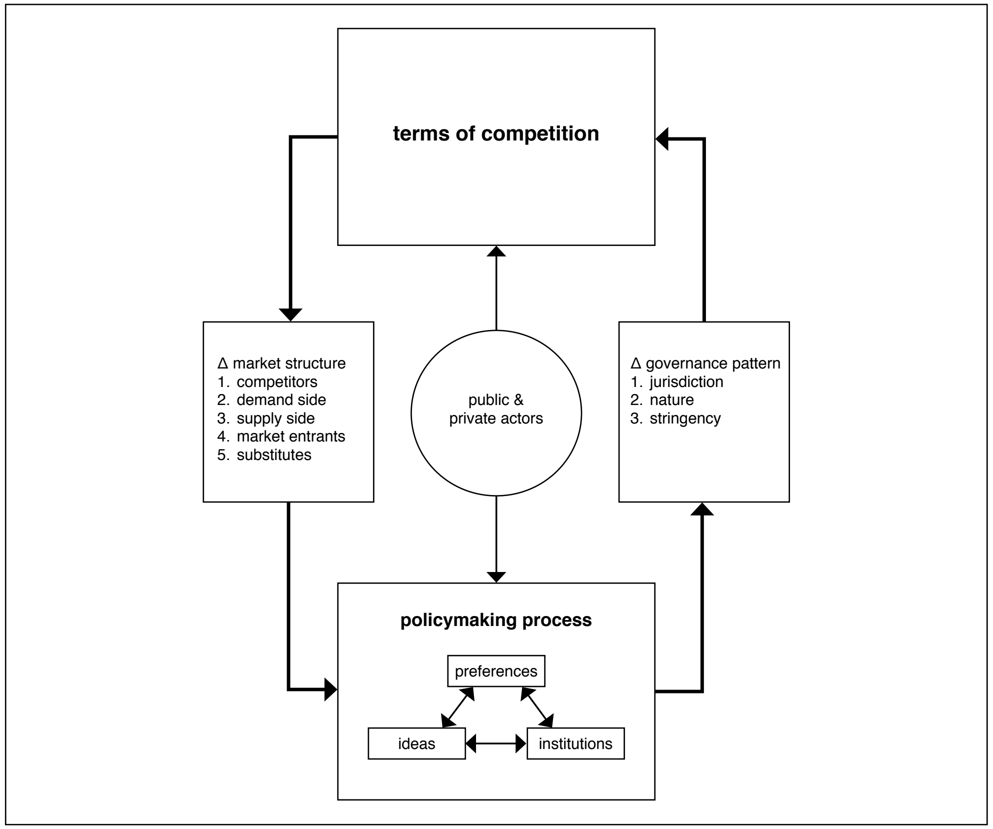
It is thus the policymaking process that functions as the crucial integrating link between changing market structures and shifts in governance, since on the part of private actors it is a part of their market activities and on the part of states it is an opportunity to advance constituencies' interests and safeguard their position as a market participant (e.g. when sourcing their financing needs from market parties). This creates a feedback loop between the outcome

[133] Underhill, 2003. See also Baron, 1995 arguing the same point from the perspective of business studies.
[134] Krueger, 1974.
[135] Underhill, 2010.

of policymaking processes (shifts in governance patterns) and changing preferences of actors regarding future governance patterns (which are fed back into policymaking processes). This feedback loop is driven by the fact that outcomes of policymaking processes change the terms of competition and thus also the structures of markets and their distributional outcomes (and resulting preferences for governance) in an ongoing fashion.

To summarise, the theoretical approach developed here leads to explanations of changes in global financial governance based on a combination of preferences, institutional contexts and ideational factors. Based on this combination, actors wage a political struggle in the policymaking process concerning global financial governance that determines the changes in jurisdiction, nature and stringency of governance. These changes alter the incentives and constraints for market actors (the terms of competition) and in such a way change the market structure. This change in market structure leads to new preferences for governance patterns from both public and private actors, feeding back into the policymaking process (and thereby completing the feedback loop, as illustrated in figure 2.1 below).

Figure 2.1. The relationship between shifting patterns of governance and changing market structures



Of key importance are consequently the relationship and interaction between private and public actors in both market exchange and policymaking processes, as well as their implications. We can only understand the search for optimal patterns of governance by inductively looking at the preferences of the diverse range of public and private actors involved and how these interact and are transformed in the institutions of policymaking. This brings us back to the question of the relationship between political institutions of states and the institutions of the market in the international domain, and how it should be conceptualised. Here, the project aims to make a contribution to the theoretical debate by bringing the Economics and Political Economy literature closer together. The aim is to better understand the search for optimal patterns of governance in the context of the realities of power relationships among a diverse range of public and private actors.

The added value of this approach lies in its account of the continuous feedback loop between shifts in governance patterns and changing market structures driving the dynamics of the financial system. Each step in the feedback loop serves to form an important part of the explanation for the next. Changes in market structures are not as exogenous as some theories would lead us to believe; they are both a reaction to competition *and* the outcomes of the policymaking process. For example, the internationalisation of international financial markets was only possible because of the political decision to liberalise financial markets and open domestic capital accounts.[136] Subsequently, the emergence of international banks led to the need for a new vision on banking supervision elaborated in the first Basel Capital Accord. New market structures and institutions in which the policymaking process is focused lead to new preferences for governance patterns, feeding back into the policymaking process. The next section elaborates on this added value by summarising the arguments made in this thesis, both on a general level and with respect to the two case studies.

Argument

This section will first of all derive general propositions from the theoretical approach elaborated above. In the following two subsections, these theoretical propositions are 'operationalised' at the level of the case studies. In the final subsection, the propositions will be summarised and generalised (as well as discussed in relation to alternative explanations). Together, this works towards elaborating the central argument of this thesis.

Theoretical propositions

The discussion above already hinted at a number of propositions, distinct from rival accounts of the developments in governance patterns and market structures. Two main theoretical propositions are presented. First, at the most general level, the research explores within the domain of financial governance the proposition that there is a symbiotic relationship between the changing structure of the market and shifting patters of governance. Changes in preferences concerning governance therefore appear intimately bound up with preferences concerning market structure: changes in markets generate changes in actor preferences concerning regulation and governance, and the outcome of conflict over divergent actor preferences concerning governance and regulation (the shifts in governance pattern) generates changes in market structures. This proposition consequently entails continuous change, which differs from propositions following from HI and NIE, which would predict more stability.

The second proposition states that public actors continue to wield crucial influence on the dynamics of the global financial system, even in the face of the huge growth of financial markets and its cross-border and cross-sector integration. The debate on states in globalised markets seems to be misguided by its implicit state-market dichotomy. As the discussion above showed, an integrated notion of changes in market structures and shifting patterns of governance points to the interaction between public and private actors as the main force behind changes in both market structure and governance pattern. Although the policymaking institutions might change, the continuing importance of (certain) public actors in producing or legitimating authoritative decisions regarding governance patterns does not. Public actors have an independent preference, linked to their position in the policymaking process *and* their role as market actor. They not only have a preference for maintaining a well-functioning market, but also for enhancing their own position in that market. While private actors might exert a strong influence on the policymaking process, their preferences regarding governance are shaped by previous decisions of private and public actors regarding governance patterns and their subsequent influence on the market structure. Also in that sense, public actors remain of continued relevance.

These propositions are further elaborated and linked to the case studies in the following two subsections. This means the propositions are 'operationalised' by showing how the theoretical approach accounts for shifts in governance across the three dimensions as well as changing market structures.

Explaining the success of the Basel Capital Accords

It will be argued that the emergence of the first Basel Capital Accord can be explained by the shifting preferences of US public and private actors that resulted from the changes in market structure put in the limelight by the Latin American debt crisis.[137] Where US public actors were eager to show themselves to be 'punishing' the banks with tougher supervisory standards, the US banks were eager to come to an international agreement on strengthened bank supervisory standards to level the competitive playing field. Due to a similar philosophy

[136] Helleiner, 1994.

[137] Compare Oatley & Nabors, 1998.

of banking regulation, the UK quickly latched on, and subsequently competitive concerns of banks that would potentially be excluded from these two largest banking markets led to enough pressure for a global agreement in the form of the Basel I Capital Accord.

It will be argued that this accord entailed a shift 'upwards' in the jurisdictional dimension. On the 'nature of governance' dimension, Basel I remained a characteristically 'public' pattern of governance. Stringency did increase as the Accord set an 8 per cent risk-weighted capital standard with fixed risk categories (relative to earlier national level governance patterns that had no formal capital requirements or less stringent standards).

This shift in governance, it will be argued, accounts for important changes in the market structure: the emergence of bigger, more diversified and highly internationalised banks with 'sophisticated' risk management practices. These banks for example increasingly engaged in securitisation of balance sheet items to reduce risks, thereby circumventing capital requirements. Due to the changes in market structures, preferences of the major banks shifted towards more market-oriented forms of governance. Public supervisors, on the other hand, realised the system was being gamed and that the risk management models of large internationalised banks needed to be addressed. These shifting preferences led to calls for a renegotiation of Basel I. Last, the shift in governance Basel I entailed also institutionalised the BCBS as the main policymaking institution. The BCBS functions as a policy community where private sector influence combines with an exclusionary group of public actors with strong interests in a thriving and open financial sector.

It will be argued that the shifted preferences and the institutionalisation of the policymaking process in the BCBS explain the subsequent outcome of the negotiations on Basel II: a shift towards less stringent, market-based forms of governance. The most advanced international banks are allowed to use their own internal risk models. This arguably also shifted the nature of governance towards more private forms, although the final check remains with the (public) banking supervisor. These changes were in accordance with the preference for market-based forms of governance of the main actors in the policy community. However, the specific shifts in governance can be explained by (1) the policymaking institution, which consists of public actors of the G10 countries and is very open to influence from large international private financial institutions; and (2) the conflict in preferences between these two groups of actors, with the public actors striving for an intellectually rigorous governance pattern (a comprehensive risk-weighted standard) and the private sector aiming for market-based patterns of governance.

It will be shown that the explanation this account offers of the developments in banking supervision is superior to explanations solely based on ideational factors (e.g. Kette's claim of learning effects[138]). These explanations fail to acknowledge the fact that the preferences of internationalised banks were satisfied over the preferences of, for example, smaller regional

[138] Kette, 2009.

banks. This means that the 'ideas' underpinning the Basel II Accord are not neutral. The same argument applies to functionalist explanations seeing Basel II as a response to globalisation as these do not account for the shifts towards market-based forms of governance.[139]

Explaining the failure of the SDRM

The sovereign debt crisis resolution case study starts with a similar dynamic as the bank capital adequacy standards case study. It will be argued that a shift in preferences of US public and private actors as a result of the Latin American debt crisis is the starting point to explain the patterns of governance for sovereign debt crisis resolution in the 1980s. US authorities took the lead in designing an ad hoc governance pattern in the form of the Baker and Brady plans. The central position of the US (both in terms of affected banks as in terms of voting weight in the IMF) allowed it to satisfy its preferences for these governance patterns, which it shared with private actors. The US was followed (sometimes reluctantly) by the European state agencies.

It will be argued that these ad hoc plans entailed a shift 'upwards' in the jurisdictional dimension of governance to the international level (not global, as the plans had no universal applicability). With respect to the 'nature' dimension of the plans, they were 'public', designed and implemented by state agencies and the IMF. The stringency of the governance pattern under the Baker and Brady plans differed for different actors. Debtor states were restrained by stringent conditionality, while private actors were steered in a much less stringent way towards co-financing of the IMF programmes and voluntary debt restructuring.

It will subsequently be argued that especially the Brady plan had an impact on the market structure by encouraging the growth of the secondary market for sovereign market debts in particular, and capital market financing of emerging markets in general. This diversification of the market explains the subsequent lack of progress in this policy domain as there were no leading actors with clear preferences for shifts in governance while the Brady plan was case-specific to address the Latin American debt crisis. Only after the East Asian crisis did a significant realignment of preferences take place.

Public actors developed a preference for better mechanisms to deal with sovereign debt crises in the face of mounting costs of official refinancing. This allowed the IMF to gain the initiative after the East Asian crisis as not only the prime policymaking institution but also a leading public actor proposing a new governance pattern. It will be argued that the preference of the IMF for a global level governance pattern in the form of an SDRM was based on economic analysis of market failures, and went against the perceived interests of private actors. It hence enticed a strong backlash by both some public national level actors and private sector actors. This led the major policy proposal for a global level public governance mechanism to be defeated by a coalition of private sector interests and debtor states.

[139] Kapstein, 1994 makes such an argument for the emergence of Basel I.

The result of this policymaking process is a shift upwards on the jurisdictional dimension in the form of a global level standard for CACs and the 'Principles for Stable Capital Flows'. These proposals are respectively of a mixed public/private and private nature (while the CAC standard is public, implementation of CACs is done by market actors). Compared to the Brady plan, this consequently entails a shift towards more private forms of governance. The new governance pattern is less stringent than the Baker and Brady plans (and definitely less stringent than the SDRM).

Summary and generalisation in comparison to alternative explanations

There seem to be interesting parallels between the cases. For both cases, the changing market structures ('globalisation of the financial system', reflected in bigger, international banks and increased capital market financing of emerging markets) have shifted the interests of actors and led to the emergence of global level policymaking institutions with a high degree of involvement of private actors. It will be argued that these developments facilitated the shift from international level public governance to global level private sector self-regulation. It will also be argued that this shows that the policymaking process cannot be explained by taking a state-centred perspective, but that market developments and private actors need to be included in the equation. At the same time it shows that the simultaneous globalisation of the financial system and the development of new forms of multilevel governance is not an autonomous and exogenous development.

In other words, in both cases we seem to see a dynamic where shifts in governance and changes in market structure occur simultaneously, through the interaction of public and private actors in the policymaking process and in market competition. Basel I contributed to the emergence of diversified and international banks with sophisticated risk management practices. This shifted private actor preferences towards the use of in-house risk models. Public actors followed this preference as they witnessed that this new market structure allowed for the 'gaming' of Basel I with the associated increases in risks. These shifting preferences led to the renegotiation of Basel I to Basel II. In the case of sovereign debt crisis resolution, the Brady plan encouraged capital market financing of emerging markets. This diversified the preferences of private actors and led to a reduced sense of urgency to make progress on this issue. At the same time, public actors (specifically the IMF) acknowledged the potential risks and proposed a comprehensive approach to deal with the issue. This was defeated by the strong involvement of private actors in the policymaking process and the lack of support among debtor nations. In short, both cases show the feedback loop posited by our theoretical model, and both cases exhibit the predicted change instead of stability.

Both cases also show that public actors' preferences reflected both an 'theoretical' understanding of how markets should function and their own market position (e.g. as borrower or provider of official refinancing). These public actor preferences complemented private actor demands (e.g. including operational risk issue in the Basel Capital Accord or the emergence of a standard for CACs). This research will thus show that it is state and private actors in collusion that drive this process. There is consequently no retreat of the state; at best there is a shift in the power balance between different public actors on the national or international level.

A final point which will be made is that the relatively closed nature of the policymaking community leads to questions of legitimacy and accountability. In both cases, the input legitimacy of the policymaking process can be questioned. Furthermore, the closed nature of the negotiations makes it difficult for elected representatives to hold the policymakers accountable. What's more, this problem is compounded by the role of the private sector. In the emerging global level policymaking institutions, private sector representatives are strongly embedded and are able to accommodate their interests better than those of outsiders to the policy community (for example parliamentarians or CSOs). The increasing importance of governance institutions at the global level has not been accompanied by significant measures aimed at improving accountability and legitimacy of this level.

Research methodology

After laying out the main arguments in the previous section, it is time to turn to the research methodology. To recap, the research questions are: (1) How has the pattern of governance shifted in the two policy domains of bank capital adequacy standards and sovereign debt crisis resolution over the period 1980 - 2005? How have the relevant market structures changed over the same period?; (2) What are the characteristics of the policymaking process leading to these shifts in the pattern of governance of the two policy domains in global financial governance?; and (3) What is the role of the policymaking process in both shifts in governance and changes in market structure? In short, how do shifting patterns of governance relate to changes in market structures? These questions will be addressed by a qualitative analysis of two case studies, backed up by quantitative data where relevant. The case studies – concerning bank capital adequacy standards and sovereign debt crisis resolution – are selected from the field of financial governance.

There are several reasons why a qualitative case study design offers the most leverage over the research questions. Qualitative case studies offer the possibility to trace the evolution of the global financial system and the historical development of the policymaking process. They will consequently map the relationship between changes in market structures and shifting patterns of governance. In other words, the long-term perspective taken in the case studies allows analysis of the changes in the jurisdiction, nature and stringency of the patterns of governance in the respective fields, and of the relationship between the associated policymaking process and the resulting changes in patterns of governance. The evolution of the interaction between these two elements of the main research questions does not occur overnight, and hence needs careful process tracing, which case studies allow.

Each individual case can consequently be examined in sufficient depth to produce a rich account of the changes. Moreover, by using case studies a nuanced classification of the actors involved can be developed showing how public and private actors interact and how in their interactions the distinction can become less clear-cut (states acting as market actors and market actors implementing governance).[140] The historical and rich account of qualitative case studies will allow for an exposition on how market dynamics shifted preferences leading to demands for shifts in governance (the feedback loop elaborated above) and will allow for the consideration (and rejection) of alternative explanations as mentioned in the argument section above. This therefore makes this an appropriate design for the testing of the propositions. In the next subsection, the selection of the two case studies will be discussed. The second subsection deals with the data sources.

Case selection

To address the research questions two policy domains in the realm of global financial governance are studied, on the one hand the policies regarding bank capital adequacy standards, and on the other the policies regarding the resolution of sovereign debt crises. The case study selection strategy aimed to locate variation in the shifts across the three dimensions of governance, in other words a 'diverse case method'.[141] Before elaborating this strategy, it should be noted that both case studies also have a significant time span. Both cases have been important policy domains for an extended period and are therefore very well suited: the negotiations on the first Basel Accord started in the early 1980s, while the issue of sovereign debt restructurings gained traction following the 1982 Latin American debt crisis. This longer history is also a reflection of the fact that these two policy domains are important enough to warrant continuing attention from policymakers.

Importantly, each policy domain had its own independent dynamic, making for two diverse case studies. Where in the case of banking supervision the renegotiation of the first Basel Capital Accord was championed by the private sector, the most important initiatives in the field of sovereign debt crisis resolution came from the public sector, notably the IMF. While the case of banking supervision concerned the revision of a global public-based governance regime, sovereign debt crisis resolution concerned a state level market-based regime. Interestingly, the policymaking process in the banking supervision case came to a successful conclusion, while in the sovereign debt crisis case the most important policy proposals were not implemented. Instead, private sector initiatives like the 'Principles for Stable Capital Flows' filled the vacuum. Both cases also show variation over time in the third dimension of governance, the stringency of regulation. The Basel Capital Accords explicitly shifted from

[140] Next to these substantial reasons for using a small-n design, as a practical matter it is also doubtful whether the universe of cases could be reasonably expanded to facilitate a large-n approach. As the research concerns the global financial system, the number of cases in financial governance is relatively small. There are some other policy domains with the necessary temporal development and global dimension (e.g. accounting standards) but not many.

[141] Seawright & Gerring, 2008; Gerring, 2006. Flyvbjerg, 2006 refers to this as selecting 'maximum variation cases'.

a specific (and perhaps arbitrary) norm to a market-based approach based on banks' own practices. The governance pattern for sovereign debt restructurings arguably shifted from no regulation to limited, market-based forms. Because of this variation in the case studies, they form a more stringent test of the proposed feedback loop than a single case study would: can the same model explain both outcomes?

The selected case studies have the benefit that important actors overlap, e.g. ministries of finance, central banks and internationalised private banks. This makes the policymaking processes and changes in market structures arguably more comparable, despite the variation in developments. It can consequently show how the same sets of interests work in distinct policy domains. This is the benefit of choosing these two case studies over other available cases (for example, European capital market integration or accounting standards),[142] where a number of different actors are involved. Yet, there is no reason to assume the cases are not representative of the broader universe of policy domains in global financial governance. Perhaps this is best illustrated by the fact that several other policy domains are also discussed in the main policymaking institutions of these cases (e.g. the IMF as a focal point of global efforts in increasing financial market transparency[143]). By using this dual case study design, the external validity of general claims derived from both case studies increases. A comparison of the historical developments in both cases will increase the validity of more general claims made about developments in global financial governance.

The aforementioned underscores that the case selection strategy was based on two concerns. On the one hand the general propositions are tested on a cross-case basis, whereby the preliminary analysis suggests the Basel case shows success in the emergence of a global level public pattern of governance and the sovereign debt restructuring case shows the failure of proposals for a similar global level public pattern of governance. On the other hand, each case has enough variation within the different dimensions over the time span of the cases to allow internal case comparisons of the case-specific propositions.

Data sources

The propositions will be held against three main data sources: documentary sources, semi-structured interviews and industry statistics. This variety of sources increases the validity and reliability of the claims based on them, since it allows for cross-validation between various sources ('triangulation').

The documentary sources consist of a range of publications and archive materials. Firstly, the press coverage of two leading outlets in the field (the *Financial Times* and the *Economist*) was collected using relevant key words. The key words were based on general characteristics of the cases (banking supervision, sovereign debt crises) and contemporary references in the

[142] For the former, see Mügge, 2010; for the latter, see Perry and Nölke, 2006.

[143] Walter, 2008.

articles resulting from the search based on general characteristics (e.g. Third World debt crisis for what is now known as the Latin American debt crisis). These two publications have regularly followed the negotiations and often provide interview data with policymakers at the time of the negotiations. The collected newspaper articles will show how the policymaking process developed (at least according to analysts of the time). A second documentary source is composed of official publications, for example reports by the relevant international organisations (IMF, BIS), communiqués of international meetings and policy statements of actors in the policymaking process. These documents demonstrate actors' preferences in the negotiations as well as document the outcomes (in terms of the shifts along the dimensions of governance). The third documentary source was the archives of the IMF (and to a lesser extent, the BIS). These documents will complement the previous two document sources by providing minutes and background documents used in closed-door negotiations. These internal documents also show more about the actors' strategies during the negotiations, while the aforementioned publications like position statements mostly deal with the content of the negotiations. Again, this will provide insights into the actual dynamics of the policymaking process, and can also function as a check on the recollection of the interviewees.

The second data source consists of semi-structured interviews with official and private sector representatives. These interviews to a large extent conformed with the notion of elite interviews of Dexter (1970) in that there was a lot of attention to the interviewees' definition of the situation and account of the policymaking process.[144] Typically, the questions concerned the interviewees' background and organisational embedding (e.g. 'how do you develop your policy position within the organisation?'), the interviewees' view of global financial governance ('what are the most important policy issues you face?') and more specific questions on the case studies ('how did the negotiations on Basel II evolve?'). A conscious effort was made to interview policymakers from various backgrounds as regards both nationality and affiliation (financial firms, public sector and CSOs) and to corroborate stories from the document sources or different interviewees.

The interview data was used to obtain a complete picture of the actual dynamics in the policymaking process. The positions of the actors in the policymaking process are developed, influenced and advocated through direct interactions that are often closed-door negotiating sessions. As a consequence interviews with the actual participants are necessary to gauge the dynamics of the policymaking process. This gives leverage on the question of the interaction of interests, ideas and institutions in the policymaking process. The interviews consequently work towards an explanation of the dynamics of the policymaking process and the resulting shifts in governance across the different dimensions.

The third data source is composed of industry statistics for the global financial system. For example, the OECD, BIS and IMF collect many relevant data series for a wide range of countries.

[144] Dexter, 2006, p. 18.

Furthermore, industry associations and individual bank reports provide valuable data. This quantitative data provides insight into the changes in market structure and is linked with the interview and document data to account for the interaction between changing market structures, shifting preferences and the policymaking process.

To sum up, the research design elaborated above allows me to answer the research questions through the historicised approach of qualitative case studies building on several independent data sources. Although each of the data sources has its own problems regarding reliability and representativeness, combining the three in triangulation overcomes these potential problems and increases the validity of my account of the process.

In the following empirical chapters, the approach developed above will be applied to the cases of bank capital adequacy standards and the resolution of sovereign debt crises. It will be shown that over the course of the 1980s and 1990s a transnational policy community based in global level policymaking institutions emerged that combined specific material interests (closely related to the private sector) with a shared view on preferred solutions (addressing market failures by market-based rules and procedures). This policy community not only resulted from the internationalisation of the financial sector, but also gave impetus to further changes in the market structure of the global financial system (such as further internationalisation and financial integration). But before delving into the cases, in the next chapter the stage is set by describing the historical background to the case studies. This next chapter will also discuss wider developments in the global financial system that are of relevance to the case studies.