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# The governance of international finance

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International finance is at the cutting edge of contemporary international economic integration. Today's global financial markets are of enormous size and can move huge quantities of money around the world with extraordinary speed and massive effect. Their impact was demonstrated with a vengeance during the Great Financial Crisis (GFC) that began at the end of 2007, during which financial markets transmitted economic impulses – many of them highly damaging – from country to country in a matter of days or weeks.

The great economic and political prominence of international financial markets has given rise to extensive discussion of the need for some way to regulate, monitor, or otherwise control their impact on national economies and polities. Indeed, the ranks of those who believe that some form of governance of global finance is desirable are clearly growing. However, even among the more fervent believers in global financial governance, it is not clear how this might be accomplished in a world whose policies are still made almost entirely by nation states.

In this essay, I evaluate the state of attempts to provide some oversight of finance at the international level that comes close to what exists at the national level. I start in Section 1 with a summary of the normative argument for international financial governance. Section 2 provides a brief overview of what has actually been done to supply something approaching global public goods in this arena. In Section 3, I move

on to analytical approaches to understanding what has been done, and might be done, in global financial governance. A conclusion follows.

### 1. Normative arguments for global financial governance

Analysts and policymakers make a variety of arguments for some form of international “governance” of global financial affairs. In this context, governance implies the provision of government-like functions, but at a level above that of the nation-state. The normative bases for these arguments, then, must be analogous to the arguments for the government provision of public goods at the national level: there are market failures such that things for which there is demand are undersupplied by private actors.

One typical form of argumentation is by analogy. As financial markets grew from being local to being national, there was a need for national public goods involved in overseeing these markets. This led all governments to provide national financial regulation and supervision (of which more below). Today’s financial markets are now global, which means that there must be a need for global public goods in overseeing the international financial markets. This is the character of many arguments for global financial governance.

An argument for *global* governance, however, requires that such global public goods cannot adequately be supplied by *national* governments. In other words, in order for there to be a case for truly global governance of international financial relations, it is

not enough (as it would be at the national level) to show that the goods in question would be undersupplied by the private sector. For global governance to be justifiable, it would have to be the case that national *governments* could not, or would not, oversee their financial affairs on their own so as to provide the desired international outcome. In other words, the argument for global governance requires demonstration that not only private actors but also national governments are insufficiently willing or able to provide something that is globally desirable. To take an analogy, in pure welfare terms international trade liberalization does not in itself require global governance inasmuch as it is the national interest to liberalize unilaterally: enough of the positive effects of trade liberalization are internalized within the liberalizing country that it has an incentive to undertake the liberalization.<sup>1</sup>

This then means that the argument for global governance must inherently involve *political economy* considerations. Unlike at the national level, where government

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<sup>1</sup> This is not to imply that there are no potential global public goods in the international trade realm: for example, the monitoring and enforcement of agreements might require some form of global governance. Scholars have suggested other such public goods in trade (and the internalization of a terms-of-trade externality). I mean only to point out that trade liberalization does not itself require global governance inasmuch as enough of the benefits of national policy are realized within the nation to make the policy nationally desirable.

provision is justifiable because private supply is insufficient to satisfy demand, at the international level global provision would have to be justified only if *national* governments did not have incentives to supply the good – and the incentives to governments are inherently political. So a normative argument for the global governance of international finance, as of anything else, requires that supporters show that national governments are either technically unable, or politically unmotivated, to provide the necessary and relevant policies. In this context, we can identify the sorts of interventions that are most commonly, and justifiably, presented as the kinds of global public goods that the global governance of international finance could or should provide.

The overarching public good at stake in this realm is financial stability. Financial markets provide important benefits to society, both domestically and internationally, by moving funds from where they are less needed to where they can be used more productively. However, they are also subject to periodic crises with substantial economic costs. Domestically, national governments have long recognized that systemic stability is unlikely to be provided sufficiently by private actors, and have intervened in a variety of ways to reduce the threat of financial instability.

A similar logic holds internationally. Financial crises that begin in one country or group of countries are often transmitted to the rest of the world, causing contagious international financial crises (Lorenzoni 2014, Borio et al. 2014). Here the *political*

*economy* argument for this sort of global public good is clear. Each national government may act to protect its own financial institutions and system, but it stops there. Measures could be taking to stabilize the international financial system, the benefits of which would be realized by all countries and all participants. However, no single country has an incentive to undertake the great costs of providing this stability: no country fully internalizes the externalities. Indeed, left to their own devices, individual governments may have incentives to encourage behavior by their own financial institutions that might give them a competitive edge but endanger international financial stability – such as engaging in risky lending, or secretive banking practices. The fact that countries do not fully internalize both positive and negative externalities in this realm provides a clear and cogent argument for global provision – global financial governance.<sup>2</sup>

There are many ways of attempting to provide financial stability. Below I examine those that have been most prominent in discussions of the governance of international financial markets.

*Lender of last resort facilities.* At least since the middle 1800s, it has been understood that financial markets are subject to “panics” or “bank runs,” in which doubts about the solvency of financial institutions can lead market participants to

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<sup>2</sup> I should note that there is a small public choice-influenced literature that contests the normative case for international financial governance, cf. Vaubel 1983 and Dreher and Vaubel 2004.

withdraw funds. These panics can be self-reinforcing, causing otherwise healthy institutions to fail solely due to a potentially misplaced loss of confidence. Such bank runs can also be contagious, and can snowball into full-blown financial crises with serious costs to society, which means that there are strong welfare arguments for avoiding them. As a result, virtually every government has agreed, in one way or another, to act as lender of last resort. This means that it stands ready to provide liquidity to the financial market to keep otherwise solvent financial institutions from being bankrupted by a contagious loss of confidence. This is not an unproblematic policy: the line between insolvency and illiquidity can be unclear, as is the best way for the government to intervene (Grossman and Rockoff 2015). However, the basic principle is well-established: governments need to stand ready to intervene in an emergency to supply funds to financial markets to avoid a descent into panic.

International financial markets are, it turns out, exquisitely susceptible to these sorts of panics. In the international financial system, which is populated by large financial institutions rather than small depositors, panic typically takes the form of a loss of confidence in the ability of other financial institutions to fulfill contracts, even for very short-term (such as overnight) arrangements. The financial components of the crisis that began in 2007 are the modern equivalent of a bank run: with intermediation taking place in markets rather than through banks, the panic that developed was about the inability of markets to reliably allow contracts to be completed and serviced (Gorton

2009). Extraordinary levels of uncertainty made it difficult or impossible for even the very largest financial institutions to borrow on the inter-bank market, a necessity for their ability to carry on everyday business.

Today's international financial system is subject to the threat of panics, which means that lender of last resort facilities are desirable. The modern system performs a function that is analogous to that of a traditional national banking system: maturity transformation with fractional reserves, underpinned by a very short-term inter-bank market.<sup>3</sup> To some extent national governments have addressed the international lender-of-last-resort problem by working out arrangements that require home-country authorities to provide these facilities to their financial institutions even when they are operating internationally. However, these arrangements have many weaknesses and vulnerabilities, such as the fact that the commitments involve many different currencies, and most observers agree that some manner of international lender of last resort facilities would be desirable (Obstfeld 2009 and Landau 2014).

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<sup>3</sup> "Maturity transformation" refers to the process whereby financial institutions borrow at short term (i.e. from depositors) and lend at long term (i.e. to mortgage holders). A fractional reserve system is one where banks have only a fraction of the money necessary to cover their liabilities (such as to depositors) available upon demand, on the principle that only a fraction of these liabilities are expected to be called at any given time.

As in the general case, the *political economy* case for an international lender of last resort is strong. Such facilities are complex and can be costly to provide in a credible way. While each national government has powerful reasons to establish lender of last resort facilities domestically, to protect its own financial institutions and system, the benefits largely stop at the water's edge. No one government can internalize the full benefits of providing liquidity to the international financial system, which makes the normative case for global provision a strong one.

*Regulatory harmonization.* Financial regulation is a central component of national efforts to provide financial stability. In fact, it can be seen as the counterpart of policies, such as the lender of last resort, to backstop the financial system: if governments are providing some sort of insurance to financial markets, they need to attempt to limit moral hazard and adverse selection. But experience has shown that a financial system with inconsistent or discordant regulatory components, whether regionally or functionally, can create serious problems. Major regulatory differences give financial institutions incentives to engage in regulatory arbitrage, designing their operations so as to find the most permissive regulations for each segment of their business.

At the international level, major regulatory differences and private-sector regulatory arbitrage can lead to an accumulation of under-regulated activities. This in turn creates the potential for very large, very international financial institutions to manipulate regulations so as to put many national regulators and financial systems at

risk. It might also lead to regulatory competition with a harmful “race to the bottom.”

And because financial crises in one major financial market are typically transmitted to other markets, lax regulation in one country can create the conditions for the inadequate regulation of one country’s financial system to cause contagious crises throughout the world.

Just as it is desirable for national financial systems to avoid regulatory fragmentation and contagious financial crises, there is a normative argument for regulatory harmonization at the international level. As with lender of last resort facilities, the argument takes into account the political economy of the issue. Individual national governments do not fully internalize the benefits of tighter regulation, and may even realize significant costs if business flees for looser jurisdictions. This means that national governments, like private firms, may not have sufficient incentives to provide adequate global regulatory consistency or rigor on their own. The case for some form of global governance – even if only cooperative arrangements among national authorities – is strong.

There are many forms that this sort of regulatory harmonization can take. Regulators can agree to impose common rules for capital adequacy, that is, how much capital banks have to hold in compared to their outstanding assets (loans and investments). This is meant to impose common standards of prudence on financial institutions. A related measure is to harmonize the treatment of “shadow banking”

activities, the activities of financial institutions that are typically outside of the normal reach of banking regulators. And harmonization can provide common standards for how national financial authorities are expected to intervene in the case of major bank failures.

*Other sources of financial stability.* There is a range of other policies that may stabilize financial systems. Especially in the aftermath of the Great Financial Crisis, there has been much discussion of interventions to either limit the likelihood of financial instability or reduce its effects.

One set of policies that has attracted a great deal of attention is “macro-prudential regulation” (Schoenmaker 2014, Engel 2015a). This takes financial regulation to a higher level, requiring regulators to supervise financial institutions so as to consider their impact on the entire financial system. This could lead regulators to influence the pace and direction of lending, focusing not simply on the solvency of individual banks but rather on the broader systemic impact of their behavior. Macro-prudential regulation requires that regulators consider the macroeconomic and systemic impact of individual bank activities, which is both complex and can be controversial: no bank wants to be denied profit opportunities solely due to nebulous “systemic” considerations. Nonetheless, the experience of recent financial crises has led many national regulators to take systemic factors much more seriously. Again, the normative case for some form of macro-prudential regulation at the global level – or at

the least for coordination of national macro-prudential policies – is strong. While national regulators have incentives to take nationally systemic effects seriously, they have no strong reasons to think about the global financial system. Again, the positive externalities are not internalized, and the national regulators are unlikely to pay due attention to potential internationally systemic implications of “their” banks’ activities.

Another policy dimension that has come in for substantial discussion recently is the use of controls on cross-border capital flows to limit their impact on domestic – and potentially international – financial conditions. Indeed, the International Monetary Fund (IMF) has indicated that it regards the judicious use of such capital controls as a reasonable response to the threat of financial instability: national authorities might limit inflows to avoid excessive borrowing, and in time of crisis might limit outflows to avoid currency runs or other destabilizing financial movements. Once more, inasmuch as national financial crises can be contagious, there is a normative basis for some global provision, or at least coordination, of policies to control capital movements. A national government that does not take global effects into consideration could encourage foreign borrowing even if it risks an eventual crisis, especially if many of the costs of the crisis are borne by foreigners (creditors or other countries infected by panic). In this context, policies to limit capital movements would best be designed with global factors in mind, in ways no national government would be inclined to do (Brunnermeier and Sannikov 2015).

*Macroeconomic policy coordination.* Divergences in macroeconomic policies are at the root of many financial difficulties. This is especially the case in a world with today's enormous capital markets and rapid capital flows: minor differences in macroeconomic conditions can lead to large financial flows that increase the divergences in ways that can exacerbate boom-and-bust cycles with substantial social costs. The normative case for macroeconomic policy coordination has been contested: a traditional view would be that responsible macroeconomic policies are unilaterally desirable, and their positive effects are fully realized by the country that pursues them, so that the incentives for such policies are strong enough not to require any international coordination. However, recent trends have strengthened the argument for coordination, given the possibility that uncoordinated national macroeconomic policies can lead to the sorts of regional and global crises that have beset so much of the world over the past twenty years (Engel 2015b, Frieden et al. 2012, Frieden and Broz 2013 provide overviews, with Taylor 2014 a mild endorsement from a skeptic). As with the other policies discussed above, there are strong political economy grounds to justify something other than purely national action: inasmuch as one country's macroeconomic policies can impose externalities on other countries, there is an argument for a supranational effort to internalize the externalities.

If we accept that financial stability is a public good, and further accept that policies to provide it at the national level create cross-border externalities that are not fully internalized, there is a normative case for providing the global public good of

financial stability at a level above that of the nation-state. This global governance might, however, take many forms. The most similar to national-level government is probably provision by a supranational institution, followed by closely coordinated provision by a coalition of national governments. Global governance could conceivably take the form of provision of the public good by one government, if enough of the benefits were realized by its home country – or if others could somehow compensate it for the job. And the governance function could be provided by non-governmental organizations, such as private, usually corporate, regulatory or standardization bodies.

The form taken by aspects of global governance is likely to depend on both on features of the issue area and of the agents involved. One dimension, familiar from the literature on federalism (including the European literature on “subsidiarity”), emphasizes that the governance structure should reflect the distribution of externalities. So if most of the positive, or negative, effects are realized by one, or a few, nations, they are both more likely to provide the governance and more likely to benefit disproportionately from it. A similar consideration could explain why a highly motivated NGO, or a group of corporations, might have powerful enough incentives to undertake the difficult task of creating a global institution to provide some of these government-like functions.<sup>4</sup>

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<sup>4</sup> Buthe and Mattli 2011, Koppell 2010, and Pauly and Coleman 2008 all look at this set of issues.

It should be noted that simply because analysis provides criteria within which some form of international financial governance constitutes a global public good does not mean that this governance is necessarily distributionally neutral. Because the definition of global public goods refers largely to nations and governments, it is perfectly conceivable that some such governance policies and structures could impose net costs on groups or individuals within countries. And there are many different, distributionally varied, ways in which public goods can be supplied. We return to this in much more detail in discussing positive analyses of global governance.

Even with a strong normative argument for global public goods, for international financial governance, we might still doubt that national governments will agree on whether or how to work together to provide such public goods. In a world of independent nation-states, cooperation to provide public goods may be the exception rather than the rule. However, the past 25 years or so provide some surprising evidence that there has in fact been an increasing tendency to work toward the provision of such global public goods in the financial realm. In the next section, I summarize some of these developments; and in the following section, I turn to how we might explain them.

## 2. Developments in global financial governance

The international financial system was hit by a series of financial crises in the 1990s, the most prominent of which were the Mexican crisis of 1994 and the East Asian crisis of 1997-1998. In each case, there was substantial contagion within the respective

region, and even outside it. And again in each case, there was enough serious concern about the implications for the international financial system that the International Monetary Fund and the national governments of the major financial centers stepped in to provide hundreds of billions of dollars to “bail out” the troubled debtor nations and supervise the restructuring of hundreds of billions dollars in private credits. The Mexican and East Asian events were followed in short order by similar, if more isolated, crises in Russia, Turkey, and Argentina.

In the aftermath of these crises, policymakers and observers began serious discussions of what was at the time usually called the International Financial Architecture. The motivation was the increasing belief that financial instability in one country or region could cause serious global problems, and required a more explicitly cooperative global response. Depending on the forum and the protagonists, this included discussions of financial regulation, macroeconomic policies, and adjustment measures.

There were several institutional developments that reflected the expressed desire for more international consultation and cooperation on financial issues. One was to enlarge the Group of Seven industrial countries to a Group of Twenty, to include some of the largest developing nations. A second was to expand the mandate of the International Monetary Fund (IMF) to include monitoring financial stability in member states, and its implications for international financial conditions. This included asking

the IMF to issue an annual Global Financial Stability Report, and later to focus its surveillance obligations on what was called a Multilateral Consultation on Global Imbalances. Finally, member states expanded the role of the Bank for International Settlements (BIS, of which more below), and established a new Financial Stability Forum to bring together central bankers, finance ministers, and other international financial policymakers to discuss common problems. (Eichengreen 1999 and Goldstein 2005 summarize the issues).

Despite these innovations, the most significant forward movement in what might be considered global financial governance came under the auspices of the BIS and its Basel Committee on Banking Supervision. This committee was originally made up of regulatory and monetary authorities from thirteen principal industrial countries (the Group of 7, plus Belgium, Luxembourg, the Netherlands, Spain, Sweden, and Switzerland). The committee began meeting in the aftermath of the first modern panic-like event, when in 1974 the failure of two mid-sized banks, one German and one American, practically froze the international inter-bank market (Spero 1980). After a series of agreements to avoid a recurrence of the problem, eventually in 1988 the committee adopted a more formal set of harmonized regulatory principles, which came to be called the Basel Accord (and eventually Basel I). The principles were implemented by the committee members by 1992. This was an unprecedented step toward cooperation among national bank supervisors, and reflected the growing belief that

there were clear systemic externalities that could not be addressed without explicit collaboration – an early step toward financial governance at the international level. Over the next decade or so, many other countries claimed to have conformed to the Basel regulatory framework. Starting in the late 1990s, the committee began a substantial revision and enhancement of the standards, eventually leading to a second agreement in 2004, called Basel II. But the implementation of this second Basel Accord was interrupted with the eruption of the Great Financial Crisis in 2007.

The GFC provoked a dramatic increase in international attempts to address global financial issues. The crisis graphically demonstrated the depth, breadth, and speed with which financial instability could spread around the world. As financial markets reached near-panic in October 2008, emergency plans were made for an unprecedented meeting of the leaders of the G20 countries. The G20 had been expanded in 1999 to include about a dozen emerging markets (including Brazil, Russia, India, China, South Africa, and Mexico), but its meetings had only been of finance ministers and similar policymakers. The November 14-15, 2008 Washington Summit brought together the heads of government or state of the G20 members. The summit, followed about five months later by another one in London, committed members to a coordinated macroeconomic response to the crisis, among several other agreements. In the event, the principal macroeconomic coordination that ensued was among the major central banks – especially the Federal Reserve, European Central Bank, Bank of England,

Bank of Japan, and Bank of Canada. Nonetheless, there was significance to the very high level of representation at the G20 meetings, and to the inclusion of major emerging markets in the deliberations.

The Group of Twenty has become the focus of many of the measures to provide some degree of global financial governance (Véron 2014). It expanded the Financial Stability Forum, now re-branded the Financial Stability Board (FSB), to include the major emerging markets. It has overseen substantive discussions over regulatory harmonization, as well as attempts to deal with the resolution of such complex issues as how to approach the regulatory and moral hazard problems associated with systemically important financial institutions.

Closely related to the G20's efforts have been redoubled attempts by the BIS's Basel Committee on Banking Supervision to address the flaws in Basel II that were revealed by the GFC. A new, significantly more encompassing, Basel Accord was developed by the committee by the end of 2010. There have been substantial revisions since then, and Basel III is unlikely to be fully implemented by major financial centers much before 2020 (Basel Committee on Banking Supervision 2014). Nonetheless, there has definitely been substantial movement toward greater coordination among national regulators, and toward a harmonization of regulatory and supervisory standards among the major financial centers.

Meanwhile, central bankers have continued to cooperate at levels that had not been seen before the crisis. This cooperation has developed more or less in tandem with an expansion of the IMF's role, especially by substantial increases in the funds available for crisis lending and emergency liquidity provision. In a variety of ways, the IMF – clearly with the approval of its principal members – is moving in the direction of acting as something like an international lender of last resort. To be sure, the funds it has available are insufficient to play this role fully, but in concert with the involvement of national governments it could be argued that the major national and supranational players in the international financial system take seriously the need for a global lender of last resort, and have worked toward that goal (the IMF summarizes its response to the crisis in IMF 2015; its response is evaluated more critically in Independent Evaluation Office 2014).

An overview of developments in international financial governance over the past decade would be that the G20's Financial Stability Board and related institutions, the BIS, the IMF, and the major financial centers have progressed toward providing an infrastructure at the global level that resembles national financial management. There are the beginnings of international lender of last resort facilities, of globally harmonized financial supervision and regulation to accompany these facilities, and of systematic collaboration among national authorities and supranational institutions. Even optimists would be likely to admit that the progress has been slow, difficult, and partial, and that

much remains to be done. But even pessimists would probably accept that there has been more movement in this direction than they had anticipated a decade ago (a most useful summary is in the annual reports of the organization New Rules for Global Finance, such as in New Rules for Global Finance 2014).

These developments call out for explanation. We would like to understand the forces that have constrained or enabled the creation of institutions and policies associated with international financial governance. Of course, an understanding of these forces is strongly affected by the theoretical tools used by scholars to analyze the politics of international financial relations. It is to an overview of the different analytical perspectives that we now turn.

### 3. Analyzing international financial governance

Whatever normative arguments may be proffered to justify the policy initiatives that have been taken in the international financial realm, the goal of scholars is to explain these developments. And scholars have approached the issue area from a variety of perspectives. These perspectives are not necessarily mutually exclusive, but they do tend to focus on different potential sources of government actions (Helleiner and Pagliari 2011 provide a useful summary).

The most simple-minded approach – which is so simple-minded as to not be represented in the scholarly literature – explains governance developments on social-welfare grounds, on the promotion of global efficiency. This is what might be called a

“functionalist” view, in the sense that governance functions grow out of the inherent demand for them. The analytical problem, of course, is that there is no agent, public or private, with a clear incentive to intervene solely in the interests of global social welfare. However, this baseline is important, and in fact somewhat contested.

Although it is common to claim that international financial initiatives are undertaken in the interests of all, as noted above, it is perfectly plausible that such initiatives may have strong distributive effects. These may involve the allocation of costs and benefits unevenly among countries: creditor nations may be able to force debtor nations into bearing a disproportionate share of the burden of adjustment to the aftermath of irresponsible lending, or large countries may be able to constrain small countries to conform to standards that harm them and their private sectors. Even if these initiatives are arrived at voluntarily among member governments, which implies that they benefit all *governments*, there may still be *domestic* distributive effects within countries. For example, a government could have no compunctions about forcing taxpayers to shoulder the full expense of reckless lending by national financial institutions.

In all these cases, while there may be social benefits to the financial stability that is enhanced by the policies in question, for individual countries or individuals within countries these benefits may be outweighed by their costs. In other words, both among countries and within countries, there is no guarantee that the governance structures will

deliver Pareto improvements. And even where the policies are Pareto improving, there are typically many ways in which they can be structured, with many different distributional implications (Krasner 1991 is the classic statement).

Analytically, the fact that these global public goods may not be distributionally neutral – whether the distributional features are international or domestic – provides a mechanism to explain how and why they might be provided in a world without global government. Again, there is an analogy to the provision of public goods at the national level. Leaving aside political entrepreneurship – which has only weak parallels at the international level – a common explanation for the provision of public goods is that they are promoted by concentrated groups that stand to benefit disproportionately from their provision. This could be because the public good in question has differential benefits, with much more significant effects on some than others (bankers vs. farmers, for example). It could also be because the public good comes “bundled” with private benefits that accrue to a concentrated group (bankers who get a cartel in return for supporting an independent central bank, for example, cf. Broz 1998).

At the international level, one could imagine that a global public good might have particularly significant benefits for some country or small group of countries; or that it might have particularly significant benefits for concentrated groups within countries, or that it might be closely associated with private benefits to some countries or groups within countries. The existence of concentrated benefits to domestic groups

could provide incentives for a government to pursue the global public good; the existence of concentrated benefits to one country or group of countries could similarly provide them with incentives to undertake the efforts necessary to supply the global public good.

For all these reasons, even scholars who accept the broad desirability of some form of international financial governance look for distributional features of their evolution that explain why such global public goods might be promoted by governments, potentially at significant national cost. One approach emphasizes the extent to which particularly large and important financial centers internalize the benefits of financial stability, which may give their governments incentives enough to play a major role in working toward global governance agreements and structures. In this picture, the disproportional size of a country can give it a disproportional interest in resolving some of the problems that arise in the absence of public goods in the international financial arena.

This approach, then, focuses on the willingness of the governments of the largest financial powers to lead the way in expanding global financial governance; and, typically, on the ability of these governments to use their power to cajole or persuade other governments to follow their lead. In somewhat different ways, for example, Kapstein (1989 and 1994), Simmons (2001), Drezner (2007), and Posner (2009) ascribe financial regulatory harmonization to the willingness and ability of countries (or, in the

case of the European Union, groups of countries) to use their bargaining power and influence to create a context to which smaller actors are forced to respond, usually by complying with the patterns set by the dominant actors.

The fact that dominant governments can strong-arm others into accepting their version of the public good in question – whether this be financial regulation, lender of last resort facilities, or something else – does not rule out the possibility that the outcome actually improves the welfare of all governments that sign onto the regime. Although the point is often implicit, it is probably the case that most scholars in this tradition think of the eventual provision of some form of international financial governance as an improvement over its absence. Inasmuch as Pareto improvements come in many distributionally relevant varieties, and as the bargaining power of the larger states gives them outsized influence on outcomes, the international governance structures that emerge are likely to be disproportionately favorable to the largest countries. One example is the role of the IMF in resolving debt crises: while it is likely in the interest of both debtor and creditor nations alike to have some mechanism to deal with such crises. Copelovitch (2010) argues that the IMF's behavior is powerfully affected by the influence of the largest, creditor, nations; Stone (2011) is even more insistent that formal and informal rules bias international financial institutions heavily toward the interest of the largest states.

A further step away from functionalist logic is to question whether in fact the governance structures are indeed welfare-improving for all. The most consistent variant of this is to note that the agreements to provide this sort of global public good is made by national governments, and that there is little guarantee that a government will be acting in the “national interest,” however defined. More specifically, national governments may be “captured” in the global financial realm by powerful domestic special interests that want to see international financial agreements bent in their favor – even if this works against the interests of their countrymen. One common argument to this effect is that the shape of global financial cooperation is strongly affected – perhaps distorted – by the particularistic interests of powerful, internationally engaged, private financial institutions. In this sense, what looks to some like global financial governance might also be described as the solidification of a global financial cartel, organized to extract resources from those outside the cartel: borrowers and taxpayers, in particular.

For these reasons, many scholars begin their analysis of international financial policies, cooperation, and governance with the concentrated interests of nationally-based economic groups – financial institutions, in particular. They then can build up to governments that may or may not have national interests in mind, but that bias their policy orientations toward the concerns of these powerful groups (Oatley and Nabors 1998; Singer 2004 and 2007). Returning to the example of the IMF in crisis resolution, Copelovitch (2010) argues that it was not just the interests of the largest countries that

were most strongly reflected in IMF policies, but more specifically the interests of the large private financial institutions from these largest countries. At an even more differentiated level, Broz (2005 and 2008) shows that support for the actions and institutions of global financial governance are contingent on their domestic distributional impact: the behavior of American legislators in making decisions on these matters is strongly influenced by the economic interests of their constituents.<sup>5</sup>

These first two modes of analysis have a lot in common, and are not mutually exclusive. They both tend to assume that international financial cooperation improves global welfare. But they both temper this view with the observation that the results are likely to be strongly biased by power differentials among countries, and among groups within countries. Both approaches rely primarily upon the behavior of national states, although they accept that government policy depends on domestic as well as international considerations. Both focus for their explanations on the economic interests of private actors and/or their reflection in the preferences of national governments.

Many scholars come at the issue either with less of an emphasis on economic interests, or with less focus on the actions of governments, or both. "Ideational" approaches to the making of foreign policy have their reflection in the international financial realm, as elsewhere. These analyses tend to emphasize the changing nature of

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<sup>5</sup> Büthe and Mattli 2011 make similar arguments but taken a step farther, to explain why some such governance is delegated directly to the private sector itself.

common understandings of the problems faced in international financial relations, and of how they might be addressed (Blyth 2002, Abelal 2007, and Chwieroth 2010 are prime examples). Clearly policymakers and others are influenced by the state of knowledge, or opinion, about these issues. If ideas converge within an “epistemic community” of experts or technocrats, or within a community of policymakers, this convergence can lead to policy outcomes that might otherwise be unimaginable. The evolution of the views of the IMF in the aftermath of the Asian financial crisis of 1997-1998, and of the more recent GFC, leads some observers to posit that this sort of ideational change can create conditions for a higher degree of global financial governance – whether under the auspices of the IMF or otherwise.

An ideas-based explanation of the management of international financial relations has resonated with many scholars, especially those who are particularly critical of mainstream, “neo-liberal,” policy prescriptions. One of the more famous variants of this view came from Washington-based economist John Williamson, who dubbed the IMF-World Bank- US Treasury view of how developing countries should manage their economies the “Washington Consensus” (Williamson 1989). In Williamson’s view, a nearly-religious attitude toward development policy had biased the recommendations coming from the IMF and the World Bank in ways that were not warranted by theory or evidence. More recently, both scholars and observers – including many politicians – have attacked governmental responses to the GFC,

especially in Europe, for an attachment to austerity that they regard as both ideologically motivated and genuinely unwarranted (Blyth 2013 is the canonical statement).

A related perspective focuses on international or domestic bureaucrats who respond both to these sorts of ideational factors as well as to more technocratic considerations, rather than on national politicians who respond to political pressures. An emphasis on technocratic bureaucracies is especially plausible in the international financial realm, where the problems and potential solutions are technically complex and well beyond the understanding of most citizens and many politicians. This provides an opportunity for experienced and well-informed officials of national governments, international organizations, or even non-governmental organizations to create strong networks that can affect both national and supranational policies (Barnett and Finnemore 2004, Porter 2005, Bach and Newman 2010, and Lall 2015 are disparate examples). These transnational networks can be particularly powerful if they are able to garner support from individual governments or groups of governments – including those not normally in the inner corridors of international financial power (Gallagher 2014).

Idea-centered and technocrat-centered approaches are often blended. Indeed, some of the more influential such analyses focus on how ideologically committed technocrats in international institutions guide the course of institutional engagement

and policy. At the same time, it is common to suggest that many of these technocratic and ideological biases are motivated by distributionally relevant considerations, such as in favor of the corporate sector (again, Blyth 2013 is an example that combines aspects of all three).

Developments in international financial politics in the aftermath of the GFC provide an opportunity to see how different perspectives might analyze the course of global financial governance. Some would emphasize the interaction of the major states, especially within the Group of 7, all concerned with the nationally specific conditions and concerns they faced. This could be augmented by seeing how the “management group” was expanded to include the Group of 20 – although the extent to which this expansion affected outcomes would be contested.

Related scholars would emphasize how bargaining among the principal national governments over how to confront the crisis was, and is, strongly constrained by the domestic conditions faced by each of the major players. Foremost among these constraints are the interests and influence of major internationally engaged private financial institutions. The domestic politics of financial regulation and monetary policy are now tightly interwoven with international financial developments, especially in the leading financial centers. There is undoubtedly plenty of evidence for the influence of powerful private-sector players, and of national policymakers, in attempting to explain the course of developments in international financial governance since 2008.

Evidence is also likely to be strong for the importance of changing ideas about the appropriate policies for today's international financial system. It is not surprising that the unprecedented level of financial integration and technological change, along with the most serious financial crisis since the 1930s, should give rise to a rethinking of the precepts that have guided policymaking. At this point much of what we know – or think we know – about international finance is up for discussion, and the pathways these discussions take have had, and will have, an impact on policymakers at both the national and the international level.

Finally, there is little question that the GFC has highlighted the centrality of technically trained policymakers in both national and international institutions. To a great extent, the principal global response to the crisis has been managed by the world's principal central banks, and while central bankers are hardly impervious to political pressure much of what they have done has been guided by their technocratic training and expertise. At the same time, the crisis has certainly enhanced the role of international institutions in the financial realm. The IMF and the BIS have both played major parts in discussions of how the world may move forward in the aftermath of the crisis, and their staffs have been important participants in these discussions.

In short, all of the factors identified by scholars as relevant to the making of international financial governance can be seen as having affected the course of the world's financial order since 2008. This much is hardly surprising: there are good

theoretical and empirical reasons for the significance of all of these factors. What remains to be argued out is whether one or more of the approaches described here turns out to out-perform the others in explaining the course of international financial events.

My own summary of recent experience, undoubtedly colored by my own theoretical prejudices, is that we can understand most of the policy reaction to the GFC with a combination of domestic politics and inter-state bargaining. Certainly the theoretical novelty of the Panic of 2008, and the unprecedented nature of the Eurozone crisis, has provided some space for policy entrepreneurship among international bureaucracies, and for new ideas. But one of the more striking features of the political economy of the crisis is just how similar it looks to previous financial and debt crises (Chinn and Frieden 2011). There has been massive conflict over how the burden of adjustment will be distributed, both within countries and among countries. The intersection of the inter-country bargaining and domestic political conflicts has been particularly prominent in the Eurozone crisis. While there have been ideas in conflict, and technocrats in the mix, it is hard to escape the conclusion that the cold hard cash at stake, both domestically and internationally, has been the dominant determinant of the course of the political economy of the crisis.

### Conclusion

International financial markets today are extraordinarily large, and wield extraordinary influence over the course of global economic and political affairs. In the

wake of the most damaging financial crisis in the last 75 years, it is no wonder that everyone from policymakers and journalists to scholars are interested to know if a higher level of international financial governance might avoid a repetition of the past decade's disasters. In a way, current discussions are reminiscent of the debates that took place in the aftermath of previous financial crises and bank panics at the national level – most of which ended up with an expansion of national financial regulation and supervision.

There are in fact good normative arguments for the development of international mechanisms to limit the damage international financial markets can cause, and enhance their benefits. At the domestic level, financial markets create positive externalities when they work well, and negative externalities when they don't, and this creates a demand for management that will be under-supplied by private actors themselves – hence the justification for government to provide the public goods associated with financial stability. At the international level, no single government has sufficient incentive to supply these global public goods – so their provision would depend on the joint decisions of several, or many, governments. But whatever the normative and theoretical argument for global public goods, the realities of international and domestic politics make their supply in practice problematic.

Nonetheless, there has unquestionably been movement toward greater global financial governance over the past 25 years, and this movement is in the direction of

providing something akin to global public goods in the financial area. It has taken the form of greater cooperation among the major financial centers, substantial movement to harmonize financial regulations among countries, a more significant role for international financial institutions, and other measures that supply some part of what is typically associated with financial stability at the domestic level.

Scholars have adduced several factors to help explain both progress, and obstacles, in the path of international financial governance. The realities of collaboration among independent, self-interested nation states may stand in the way, although if some countries expect to benefit disproportionately from international financial stability they may be more likely to work hard to contribute to it. By the same token, inasmuch as powerful groups – especially private financial institutions – anticipate great private benefits from greater international financial governance, they will be inclined to pressure their governments to work in that direction. At the same time, trends in the intellectual understanding of international financial problems, and of how they might most effectively be addressed, can affect the ways in which national and international policymakers confront the problems they face. This is especially true when the policymakers are united by common technical training, and by long experiences of working together either as national policymakers or in international financial institutions.

The international financial system is likely to continue to grow, and continue to expand in influence over the global economy, and the economies of every country. It is just as likely to continue to be subject to periodic tensions and pressures, and at times these tensions will almost certainly erupt into full-blown financial crises. Crises have always been endemic to financial markets, and we have no reason to believe that the near future will be different from the past. National governments have gradually developed ways to limit – not eliminate – the damage from these financial stresses at the domestic level. The evidence of the past several decades is that the world’s major governments, along with major international financial institutions, are moving gradually and haltingly in the direction of managing international financial affairs more comprehensively at the global level. This does not necessarily mean that the results of these efforts will be some magical resolution of global problems, or even that they will make most people and most countries better off. But there are prospects for progress in addressing the potential costs of international financial integration, and enhancing its positive effects. It is important to understand these prospects, and the obstacles to their realization.

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