STATES AND THE REEMERGENCE OF GLOBAL FINANCE

From Bretton Woods to the 1990s

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CHAPTER ONE

Introduction

THE GLOBALIZATION OF FINANCIAL MARKETS HAS BEEN ONE OF the most spectacular developments in the world economy in recent years. Although international financial markets flourished in the late nineteenth and early twentieth centuries, they were almost completely absent from the international economy during the three decades that followed the financial crisis of 1931. Beginning in the late 1950s, however, private international financial activity increased at a phenomenal rate. Global foreign exchange trading, for example, was negligible in the late 1950s but by the early 1990s had grown to a daily value of roughly $1 trillion, almost forty times the daily value of international trade. Similarly, gross international capital flows totaled $600 billion by the end of the 1980s, a figure almost twice the size of aggregate global current account imbalances.[1]

Most explanations of the globalization of financial markets discount the role played by states. According to this view, unstoppable technological and market forces, rather than state behavior and political choices, were the prime movers behind the phenomenon. As Walter Wriston recently argued:

> Today we are witnessing a galloping new system of international finance. Our new international financial regime differs radically from its precursors in that it was not built by politicians, economists, central bankers or finance ministers, nor did high-level international conferences produce a master plan. It was built by technology…[by] men and women who interconnected the planet with telecommunications and computers.[2]

In recent years, a growing number of scholars in the field of international political economy have challenged this historical account. They have not ignored technological and market developments, but they emphasize the importance of states in the process of globalization. Louis Pauly, for example, has argued that "a global village does not just spring up: it must be created. Politics within distinct state structures remains the axis around which international finance revolves."[3] Similarly, Jeffry Frieden has stressed that "political consent made the global financial integration of the past thirty years possible."[4] Susan Strange, too, has emphasized that "it is very easily forgotten that [international financial] markets exist under the authority and by permission of the state, and are conducted on whatever terms the state may choose to dictate, or allow."[5]

Existing IPE studies of the globalization of financial markets, however, tend to concentrate on certain stages of the process or on the experience of individual countries. I attempt to provide here a more synthetic "political" history of the globalization process which focuses primarily on the crucial role played by advanced industrial states. In addition to assuming this historical task, I have sought to answer a key analytical question: Why has such an open international financial order emerged in an era when states have retained numerous restrictive trade practices?

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Indeed, the divergent experience in the areas of international trade and international finance in recent years has given considerable strength to the argument that the globalization trend in finance has somehow been beyond politics. If this view is to be successfully challenged, it is necessary to explain why state behavior in matters of international finance has been different from that pertaining to international trade. This explanation might also have broader relevance for IPE debates concerning state behavior relating to open, liberal international economic orders, debates that have until now focused primarily on state behavior with regard to the trade sector.

The book is organized in three parts, the first of which is an analysis of the relationship between the globalization process and the early postwar international economic order. The second part is an explanation of how and why states have promoted the globalization of financial markets since the late 1950s. The concluding chapter addresses the question of why state behavior in finance has been so different from that in trade in recent years. The arguments of each part are briefly summarized in this introductory chapter.

The Restrictive Bretton Woods Financial Order

Among policymakers and scholars concerned with international economic issues, there is a widely held view—even "an article of faith," as Paul Volcker has described it—that the United States used its overwhelming power in the early postwar years to establish an open, liberal international economic order.[6] Since the early 1980s, however, this conventional wisdom has come under attack. John Ruggie, for example, argued persuasively in an article published in 1982 that the United States did not in fact promote a purely liberal international economic order at the 1944 Bretton Woods Conference. Rather, it built an "embedded liberal" order in which restrictive economic practices required to defend the policy autonomy of the new interventionist welfare state were strongly endorsed.[7] A second influential revisionist work was Alan Milward's 1984 study, which asserted that the importance of Marshall Plan aid in the reconstruction of Western Europe had been greatly exaggerated.[8] More recently, other scholars have also questioned the notion that the United States used its power in the early postwar years to build a liberal international economic order.[9]

The first part of this book provides strong support for the revisionist school by demonstrating that the globalization of financial markets should not be seen as a direct consequence of the international economic order established under U.S. leadership in the early postwar years. As explained in Chapter 2, the Bretton Woods negotiators, under American leadership, explicitly opposed a return to the open, liberal international financial order existing before 1931. Indeed, they constructed a decidedly *non*liberal financial order in which the use of capital controls was strongly endorsed. As U.S. Treasury Department Secretary Henry Morgenthau told the conference, the goal of the Bretton Woods Agreement was to "drive the usurious moneylenders from the temple of international finance."[10] Chapter 3 makes clear that advanced industrial states remained strongly committed to this restrictive international financial order in the early postwar years, employing extensive

capital controls throughout the 1940s and 1950s. Even U.S. policymakers, who chose not to use capital controls in this period, were remarkably accepting, and indeed supportive, of the use of capital controls abroad. In the late 1950s and early 1960s, when Western Europe and Japan finally restored the convertibility of their currencies, the United States also fully supported their decision not to extend convertibility to the capital account.

Four explanations can be given for the widespread use of capital controls and the wariness of states throughout the advanced industrial world to accept a liberal international financial order in the early postwar period. First, following Ruggie's analysis, the use of capital controls was prompted in part by the prominence of an embedded liberal framework of thought in this period. Although they acknowledged the validity of the liberal case that some capital movements were beneficial, "embedded" liberals argued that capital controls were necessary to prevent the policy autonomy of the new interventionist welfare state from being undermined by speculative and disequilibrating international capital flows. The embedded liberal normative framework in finance was strongly backed by a new alliance of Keynesian-minded state officials, industrialists, and labor leaders who had increasingly replaced private and central bankers in positions of financial power in the advanced industrial world during the 1930s and World War II. Whereas the bankers continued to support a liberal ideology in finance, members of this new alliance favored more interventionist policies that would make finance the "servant" rather than the "master" in economic and political matters.[11]

The second explanation of the support for the restrictive Bretton Woods financial order was the widespread belief in the early postwar period that a liberal international financial order would not be compatible, at least in the short run, with a stable system of exchange rates and a liberal international trading order. This belief stemmed from the experience of the interwar period, when speculative capital movements had severely disrupted exchange rates and trade relations. It also reflected early recognition of a point that has increasingly been emphasized in recent years by Robert Gilpin and others: that different elements of a liberal international economic order are not necessarily compatible.[12] Faced with a choice between creating a liberal order in finance and building a system of stable exchange rates and liberal trade, policymakers in the early postwar period generally agreed that free finance should be sacrificed. As Lawrence Krause notes, the financial sector was thus assigned a kind of "second-class status" in the postwar liberal international economic order.[13]

The third explanation concerns the sympathetic attitude adopted by the United States toward the use of capital controls in Western Europe and Japan. Although this stance in part reflected the first two factors, it also stemmed from American strategic goals in the cold war after 1947. On one hand, U.S. strategic thinkers were reluctant to alienate their West European and Japanese allies by pressing for unpopular liberalization moves. On the other, as Michael Loriaux has also recently pointed out, U.S. strategic thinkers actively supported financial interventionism abroad as part of a larger effort to promote economic growth in Western Europe and Japan.[14] Indeed, U.S. officials were often more enthusiastic advocates of embedded liberal financial policies abroad than were the policymakers in these countries for this reason. The cold war thus prompted the United States to assume an accommodating or "benevolent" form of hegemony over Western Europe and

Japan after 1947; it both yielded to their preference for capital controls and actively supported measures that might foster their prosperity.

There was, however, one brief interval after the Bretton Woods conference and before the onset of the cold war when U.S. foreign financial policy took a different tack. Between 1945 and 1947, leading members of the New York financial community dominated U.S. foreign economic policy and tried to create a more open international financial order by applying more aggressive pressure on Western European countries to liberalize their exchange controls and restore monetary stability. The 1947 economic crisis in Europe, however, marked the failure of the initiative. Although the crisis has usually been attributed to the severity of the economic dislocation in Europe following the war, Chapter 3 suggests that a key cause was the behavior of the New York bankers themselves. Their refusal to cooperate with West European governments in curtailing enormous, disruptive capital flight from Europe to the United States in this period contributed substantially to Europe's economic difficulties. Their behavior stemmed primarily from their direct interest in receiving the capital as the leading international bankers after the war. This shortsightedness constitutes the final explanation for why a more open international financial order did not emerge in the early postwar years.

Explaining the Globalization of Finance

If states were so wary of international movements of private capital in the early postwar years, what explains the reemergence of global financial markets since the late 1950s? Most histories of the globalization of finance stress the influence of technological changes and market developments. The growth of global telecommunications networks is shown to have dramatically reduced the costs and difficulties of transferring funds around the world. At least six market developments are said to have been significant. The first was the restoration of market confidence in the safety of international financial transactions in the late 1950s. This confidence had been shaken by the 1931 crisis and the subsequent economic and political upheavals. The second was the rapid increase in the demand for international financial services that accompanied the growth of international trade and multinational corporate activity in the 1960s. Third, private banks responded quickly to the global financial imbalances caused by the 1973 oil price rise, encouraging enormous deposits by oil-producing states and the borrowing of those funds by deficit countries. Fourth, the adoption of floating exchange rates in the early 1970s encouraged market operators to diversify their assets internationally in the new volatile currency markets. Fifth, the disintegration of domestically focused postwar financial cartels throughout the advanced industrial world in the 1970s and 1980s forced financial institutions to enter the international financial arena to supplement their declining domestic profits; such a move also enabled them to evade remaining domestic regulatory constraints. Finally, the market innovations that were created in this increasingly competitive atmosphere, such as currency and interest rate futures, options and swaps, also reduced the effective risks and costs of international financial operations.

According to this interpretation, states have played only a minor role in the glob-

alization process. In particular, they are said to have been unable to stop the trend because of the impossibility of controlling international capital movements, which in turn is said to have stemmed from two characteristics of money: its mobility and its fungibility. As Lawrence Krause explains, "[Money] can be transmitted instantaneously and at low cost—indeed, with the mere stroke of a hypothetical pen. It can be inventoried without physical deterioration and without warehousing cost. It can change its identity easily and can be traced only with great effort, if at all."[15] Increasing international economic interdependence and technological change only multiplied the opportunities for market operators to evade controls, particularly those in the form of "leads and lags" in current account payments. It has thus become common to argue that the endorsement of capital controls at the Bretton Woods Conference was largely useless in that it exaggerated the capacity of states to control capital movements.[16]

As will be discussed in Part 2, this attempt to downplay the importance of states is not convincing. International financial markets were able to develop only within what Stephen Krasner and Janice Thomson refer to as "a broader institutional structure delineated by the power and policies of states."[17] Two questions arise: *How* were the actions and decisions of states important to the globalization process? *Why* did states increasingly embrace an open liberal international financial order after having opposed its creation in the early postwar years?

9 Highlighters

What Role Did States Play in Globalization?

Advanced industrial states made three types of policy decisions after the late 1950s that were important to the globalization process: (1) to grant more freedom to market operators through liberalization initiatives, (2) to refrain from imposing more effective controls on capital movements, and (3) to prevent major international financial crises.

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The policy decision to allow market operators a greater degree of freedom through liberalization moves has received the most attention in the growing body of IPE literature. It was first in evidence in the 1960s when Britain and the United States strongly supported growth of the Euromarket in London. This market served as an offshore regulation-free environment in which to trade financial assets denominated in foreign currencies, predominantly U.S. dollars. In a world of extensive capital controls, it was a kind of "adventure playground" for private international bankers, marking a significant break from the restrictive financial relations that had characterized the early postwar period.[18] Although the market has sometimes been described as "stateless,"[19] it could not have survived without the backing of Britain and the United States. Britain's support for the Eurodollar market was crucial because locating the market in London meant that it could operate free of regulation. The support of the United States was equally important because of the dominant presence of American banks and corporations in the market. Although it had the power to do so, the United States did not prevent these institutions from operating in the market.

States also granted market operators an extra degree of freedom after the mid-1970s when they began to abolish their postwar capital controls. Once again, the United States and Britain played a leading role. In 1974, the United States initiated this liberalization trend by removing the various capital controls it had in-

troduced briefly in the mid-1960s. Britain followed in 1979, eliminating its forty-year-old capital controls. The American and British actions were copied by other advanced industrial nations in the 1980s. In 1984–85, Australia and New Zealand abolished capital controls that had been in place for almost a half-century. Many European countries initiated financial liberalization programs in the mid-1980s, and by 1988 all countries in the European Community had agreed to remove their controls completely in two to four years. The Scandinavian countries announced similar commitments in 1989–90, and Japan gradually dismantled its tight post-war capital controls throughout the 1980s. By the end of the decade, an almost fully liberal financial order had been created in the OECD region, giving market operators a degree of freedom they had not had since the 1920s.

The second type of policy decision of states—to refrain from imposing more effective capital controls—has not received extensive analysis in IPE literature. Although it is true that states find it difficult to control capital movements, the authors of conventional histories of the globalization process have generally overlooked the fact that the Bretton Woods architects discussed these difficulties and outlined two specific mechanisms for overcoming them. First, they argued that capital controls could be made to work through cooperative initiatives in which controls were enforced at both ends, that is, both in the country that sent the capital and in the country that received it. Second, they concluded that evasion of capital controls could be prevented through the use of comprehensive exchange controls in which all transactions—capital account *and* current account—were monitored for illegal capital flows. Because both mechanisms found their way into the final Bretton Woods Agreement, it is necessary to explain why states chose not to use them in an attempt to render their capital controls more effective.

In fact, there were a number of episodes in the 1970s and early 1980s when policymakers seriously considered, but ultimately rejected, the use of these mechanisms to reverse the globalization trend. Despite the lack of attention given to these decisions in histories of the globalization of finance, each represented a key turning point in the globalization process. The first such turning point was in the early 1970s, when the increase in speculative capital flows threatened the Bretton Woods stable exchange rate system. Because limited capital controls had failed to contain these speculative capital movements, governments in Japan and Western Europe pressed for the introduction of cooperative controls on capital movements as a way of preserving the stable exchange rate system. Controls were to be imposed both in countries receiving capital flows and in countries sending them, as well as in "throughflow" countries such as those housing Euromarket centers. This ambitious initiative would have dealt a strong blow to the embryonic globalization trend. Although the proposal had considerable support, the U.S. refused to endorse it. Indeed, the United States not only opposed cooperative controls in this period but also began, for the first time since 1945–47, to urge other countries to follow its lead in abolishing existing capital controls. Without U.S. support, other countries were forced to abandon the initiative. Given the importance of the United States in international finance, its cooperation was clearly necessary for such a regulatory effort to succeed.

The second turning point occurred in the late 1970s and early 1980s, in four instances when policymakers gave serious consideration to the implementation of more effective capital controls. Whereas the Japanese and West European ini-

tiative in the early 1970s had been driven by a desire to defend the Bretton Woods stable exchange rate system, these initiatives were intended to preserve the Bretton Woods commitment to policy autonomy in the increasingly open global financial environment. In the first two instances, the British government in 1976 and the French government in 1982–83 contemplated the introduction of comprehensive exchange controls in order to defend their expansionary macroeconomic programs from the disruptive effects of speculative capital flight. Only after extremely divisive internal debate was the option ultimately rejected by each government. These decisions were important in the history of the globalization process. As participants at the time recognized, the introduction of tight exchange controls by a major advanced industrial state in this period would have seriously challenged the underlying trend. The introduction of exchange controls in Britain, in particular, would have removed one of the key pillars of the emerging global financial order, the Euromarket centered in London.

The other two instances in this period involved the United States. During the 1978–79 dollar crisis, U.S. policymakers briefly considered the reintroduction of capital controls in order to preserve some degree of policy autonomy in the face of speculative market pressures. Despite the severity of the crisis, they rejected the idea. This decision marked an important turning point because it demonstrated the strength of the U.S. commitment to the emerging open international financial order, a commitment that had been increasing since the 1960s and that would become more overt in the 1980s. In 1979–80, the U.S. Federal Reserve made a brief attempt to persuade central bankers in other Western nations to cooperate in reregulating the Euromarket in order to prevent its operations from interfering with U.S. domestic monetary policy. Had this initiative succeeded, it would have significantly reduced the market's size and weakened some of the key forces contributing to the liberalization trend in the 1980s. It failed, however, because of strong domestic opposition and the opposition of Britain and Switzerland.

The importance of the third type of policy decision—to attempt to prevent major international financial crises—is rarely acknowledged by those who point to the inevitability of the globalization trend in the face of market and technological pressures. The danger posed by these crises is that, if uncontained, they would likely encourage market operators to retreat to their domestic markets and prompt states to introduce tight capital controls. Both developments, for example, followed the 1931 crisis, thus bringing down the liberal international financial order of the 1920s.

Three major crises struck the emerging open financial order in the postwar period: the international banking crisis of 1974, the international debt crisis of 1982, and the stock market crash of 1987. All three crises were prevented from spiraling out of control because states acted decisively to contain them through lender-of-last-resort action; that is, the extension of emergency assistance to institutions, countries, or markets that were experiencing a sudden withdrawal of funds. In 1974 and 1982, the United States played the key role. U.S. policymakers were also supported in each case by Britain as well as by the close cooperation of central banks from the G-10 countries.[20] In 1987, the G-10 central banks acted together in the lender-of-last-resort role. Their action was also bolstered by decisive steps that the Japanese government took in its own markets. In addition to these crisis-management activities, G-10 central banks—prompted by the United States and

Britain—also made important moves to prevent further crises from occurring in the 1970s and 1980s. In the mid-1970s, they bolstered the confidence of private international financial operators by reassuring them that lender-of-last-resort action would extend to new international financial markets such as the Euromarket. Throughout this period, they also expanded their supervision and regulation of international financial activities in an effort to curtail imprudent market behavior.

Why Did States Support Globalization?

Why did states increasingly embrace an open, liberal international financial order in these ways beginning in the late 1950s, after supporting the restrictive Bretton Woods order in the early postwar years? There are four explanations (discussed more fully in Part 2) for this change in attitude.

First, attempts to preserve the Bretton Woods order met with several inherent political difficulties. The creation of the Euromarket showed the ease with which individual states (the United States and Britain) could significantly undermine the order unilaterally by offering mobile financial traders a location in which to operate without regulation. Equally important, individual states—once again the United States and Britain—could unleash competitive pressures that indirectly encouraged liberalization and deregulation throughout the system. When these two states supported growth of the Euromarket in the 1960s and then liberalized and deregulated their financial markets in the 1970s and 1980s, foreign financial centers increasingly witnessed their business and capital migrating to these more attractive markets. To compete effectively for this mobile financial business and capital, they were forced to follow the lead of Britain and the United States by liberalizing and deregulating their own financial systems. This "competitive deregulation" in finance was a central reason for the flurry of liberalization activity throughout the advanced industrial world in the 1980s.[21]

Political difficulties also hindered implementation of the two mechanisms outlined at the Bretton Woods conference for more effectively controlling capital movements. The introduction of cooperative controls could easily be vetoed by a major state or group of states, as shown by the United States in the early 1970s and Britain and Switzerland in 1979–80. The use of comprehensive exchange controls would impose large economic and political costs, especially in the increasingly interdependent world economy of the 1970s and 1980s, as policymakers in Britain and France in 1976 and 1982–83 were forced to recognize. Thus, although it may have been technically possible to control capital movements more effectively by means of the two mechanisms suggested at Bretton Woods, both were politically difficult to implement in practice. Indeed, these political difficulties had been encountered in the early postwar years as well and were then temporarily handled only by the creation of costly offsetting financing networks (as described in Chapters 3 and 4), a solution that proved difficult to sustain in the 1970s and 1980s.

The second explanation for the unraveling of the Bretton Woods financial order relates to the strong interest of the United States and Britain after the late 1950s in promoting a more open international financial order. The United States abandoned its early postwar support for the restrictive Bretton Woods order in large part because of its changing global position. In the early postwar years, the economic strength of the United States and its strategic interests in the cold war encouraged

it to assume a "benevolent" hegemonic position in the Western alliance. Many analysts have suggested that beginning in the 1960s, the United States gradually adopted a more self-centered or "predatory" foreign economic policy because of growing current account and budget deficits. In particular, the United States began to seek foreign help in financing and adjusting to these deficits, in order to maintain its policy autonomy.[22] This more aggressive foreign policy strategy relied largely on what Susan Strange calls the unique "structural power" of the United States within the emerging open global financial order.[23] Its hegemonic position in trade may have been declining, but the United States retained a dominant position in this financial order well into the 1980s because of the relative attractiveness of U.S. financial markets, the preeminence of U.S. financial institutions and the dollar in global markets, and the relative size of the U.S. economy. This hegemonic position in the emerging open global financial order provided the United States with a fundamental reason for promoting the globalization process from the 1960s through the 1980s.[24]

Whereas U.S. support for globalization reflected its existing hegemonic position in world finance, British support was rooted in a "lagging" hegemonic financial policy.[25] Long after Britain had lost its nineteenth-century position as a financial hegemon, British financial authorities remained wedded to the notion that London should be an international financial center. This commitment stemmed from the strength of what Geoffrey Ingham has called the "Bank of England-Treasury-City nexus" in British politics.[26] From the 1931 sterling crisis to the 1950s, London's international financial position was ensured because the city served as the financial center for the closed sterling bloc. As the long-term viability of this bloc came increasingly into question in the late 1950s, however, British financial authorities realized that London's international position might be better preserved if it were to act as a financial center for offshore dollar transactions. This realization led to their support for the Eurodollar market in the 1960s and more broadly for the globalization process in the 1970s and 1980s.

It was not just the United States and Britain whose interests in promoting globalization were related to their respective positions of power (present and past) in world finance. Japan's leadership role in stabilizing the 1987 stock market crash and its financial liberalization program in the 1980s were also associated with its growing importance in the international financial order in this decade. Whereas Britain's actions reflected the lagging behavior of a power in decline, Japan's represented the "leading" behavior of a financial power on the rise. Three considerations encouraged Japan to take a keen interest in financial openness in the 1980s before it had achieved a hegemonic financial position. First, and most important, its rapid and enormous accumulation of external financial assets beginning in 1981 gave Japan an important stake in global financial stability. Second, its strong political and economic dependence on the United States encouraged Japanese policymakers to respond to U.S. pressure for financial liberalization and to act promptly when the 1987 crisis threatened U.S. financial stability. Third, Japan's financial liberalization was also accelerated by an upheaval in the domestic financial system beginning in the mid-1970s caused primarily by an increase in government deficits.

In addition to the inherent political difficulties associated with maintaining the Bretton Woods financial order and the unique "hegemonic" interests of these three powers, the third explanation for states' growing enthusiasm for the globalization

process was the increasing rejection of the embedded liberal framework of thought (on which the Bretton Woods financial order was based) in favor of a neoliberal framework in the 1970s and 1980s.[27] Neoliberal advocates favored a liberal international financial order on the grounds that it would enhance personal freedom and promote a more efficient allocation of capital both internationally and domestically. Neoliberals also rejected the two reasons outlined at Bretton Woods for justifying capital controls. First, they disregarded the postwar concern that speculative capital flows would disrupt the Bretton Woods exchange rate system by arguing strongly in favor of floating exchange rates. Second, they did not seek to preserve the policy autonomy of the interventionist welfare state but rather supported freer domestic markets and more orthodox fiscal and monetary policies. Indeed, neoliberal advocates praised international financial markets for prompting states to adopt these policies.

Although the ideological shift to neoliberalism took place at varying rates of speed and degrees of intensity in different countries, several factors explain its prevalence throughout the advanced industrial world. Many policymakers began to embrace neoliberal ideas for the practical reason that they found it increasingly difficult to continue to support embedded liberal policies in the increasingly open financial environment of 1970s and 1980s. The shift was also encouraged by important thinkers such as Milton Friedman and Friedrich Hayek who developed neoliberal ideas and helped to build intellectual networks, often transnational in scope, in order to promote them, as had Keynes and his supporters in the 1930s and 1940s.[28] The neoliberal movement gained added strength from the economic slowdown in the 1970s and 1980s, which, like that in the 1930s, eroded support for existing economic paradigms and created an intellectual climate in which neoliberal ideas were more easily embraced. Finally, neoliberal ideas were also supported by a coalition of social groups throughout the advanced industrial world in the 1970s and 1980s that differed considerably from that which had supported embedded liberal ideas in the early postwar period. This coalition included representatives of multinational industrial firms, who increasingly favored a liberal international financial order as their operations became more internationalized, and officials of private financial institutions, who had, for the most part, supported financial liberalization throughout the postwar period but whose enthusiasm was strengthened by the competitive financial environment of the 1970s and 1980s.[29] The neoliberal financial message also found strong support among officials of central banks, finance ministries, and international financial organizations, who had often been wary of the interventionist financial practices of the early postwar years.[30]

The fourth explanation for state support for globalization is that the important cooperation of central bank officials from G-10 countries in preventing major international financial crises was aided enormously by the existence of an increasingly sophisticated "regime" based around the Bank for International Settlements (BIS) in Basel.[31] These central bankers were the most cautious of the neoliberal advocates in their endorsement of a fully liberal, deregulated global financial order. They not only worried that the operations of such an order would conflict with domestic monetary policies but, more important, they feared instability and crises in the new global financial markets. To prevent such crises, they cooperated closely in a number of ways that have already been noted. This close pattern of

cooperation was facilitated not only by U.S. and British leadership, but also by the BIS-centered regime. The BIS had been set up by private and central bankers in 1930 to help reduce the international financial instability and reparations problems of that era by providing a forum where the world's leading central bankers could be brought together for monthly meetings. Although it failed to prevent the 1931 crisis, the institution acted as a helpful meeting place for central bankers in the 1970s and 1980s to devise cooperative means of minimizing financial instability. Understandings built through the frequent BIS meetings proved crucial in fostering cooperative central bank responses to each of three major crises in this period. Moreover, in the wake of each crisis, central bankers met within the BIS to construct an increasingly sophisticated set of norms, rules, and decision-making procedures for handling and preventing future crises. These norms, rules, and procedures identified and allocated responsibilities for both international lender-of-last-resort action and the regulation and supervision of international financial markets. These provisions did much to diminish problems of collective action involved in maintaining global financial stability by changing expectations, providing information, and institutionalizing cooperation among central bankers.

The prominence of this BIS-centered regime dedicated to the principle of preserving stability in international financial markets reflected a further way in which the international financial order had changed from that outlined at Bretton Woods. The Bretton Woods authors, after all, outlined no specific mechanisms for preventing international financial crises, save that of imposing capital controls. Furthermore, the association that many Bretton Woods negotiators drew between the BIS and the pre-1931 liberal era of international finance had led them to pass a motion at the conference calling for the institution's abolition "at the earliest possible moment." This resolution, however, was never enforced. Saved from abolition, the institution reemerged to perform the function that the international bankers of the pre-1931 era had hoped it would. As Fred Hirsch said, it was "a link between the old financial world and the new."[32]

Why Have States Acted So Differently in Trade and Finance?

In the concluding chapter the discussion returns to the question of why states increasingly embraced an open, liberal international financial order at a time when they retained numerous restrictive trade practices. Five explanations are given for this difference in state behavior. First, the unique mobility and fungibility of money ensured that policymakers were not faced with the same collective action problems in creating and maintaining an open international financial order that existed in the area of trade. A more open financial order could be *created* by a state that unilaterally provided resourceful financial market operators an extra degree of freedom, as did Britain and the United States when they supported the Euromarket in the 1960s. The competitive deregulation dynamic also demonstrated that collective action problems were less relevant to the liberalization process because the key benefit of financial openness—attracting footloose global financial business and funds to a country's own market—was "consumed" through unilateral rather than collective action. The task of *maintaining* an open financial order also

presented few collective action problems. For example, there was less need to create a collective regime to police against unilateral moves toward closure because such moves were unlikely, given the high cost of introducing comprehensive exchange controls in the 1970s and 1980s. The other mechanism for more effectively controlling capital movements—cooperative controls—was equally problematic because individual states could veto such an initiative. Indeed, in this sense, collective action problems were more relevant to creating a closed financial order than to maintaining an open one.

Although collective action problems were not present in these respects in finance, they did exist with respect to two activities necessary to prevent financial crises: international lender-of-last-resort action and international prudential supervision and regulation.[33] These problems were partly overcome with the consolidation of the central bankers' regime centered around the Bank for International Settlements. This regime could be strengthened at a time when the postwar trade regime was increasingly encountering difficulties in part because central bankers as a group had much in common with what Peter Haas has termed "transnational epistemic communities."[34] To a much greater degree than trade officials, they shared a similar knowledge base, common causal and principled beliefs, and the collective policy project of seeking to prevent international financial crises. This contrast in the nature of the interaction of central bankers and that of trade officials constitutes the second explanation for the differing pattern of state behavior in international finance and trade.

The successful handling of financial crises, as well as the consolidation of the BIS-centered regime, also related to the third explanation: the unique "hegemonic" interests of the United States, Britain, and, more recently, Japan in the financial sector. In assuming a leadership role in these areas, and in promoting financial openness in other important ways, these three states displayed a particular enthusiasm for the emerging open, liberal financial order, a sentiment that was stronger than their support for open, liberal trade in this period. A key reason for their different approach to the two sectors was that each had "hegemonic" interests in finance that they did not have with respect to trade. In contrast to its declining position in international trade, the United States retained its hegemonic position in the emerging open global financial order well into the 1980s, a position from which it derived important benefits. The hegemonic lag that explained British support for globalization was politically more sustainable in finance than in trade primarily because the Euromarket provided London bankers with a mechanism by which to regain their leading position in international finance. Japan's leadership was more evident in finance as the decade of the 1980s progressed than in trade, largely because of its rapid accumulation of external financial assets after 1981.

The fourth explanation is that the neoliberal advocates had more influence in the international financial sector than in the trade sector in the 1970s and 1980s, for the most part because of the relatively low domestic political visibility of the issue of financial liberalization among politicians and the general public.[35] Financial liberalization attracted relatively little attention partly because of the seemingly complex and highly technical nature of international financial issues. Consequently, supporters of neoliberal ideas in academia, financial bureaucracies, and the private sector had considerable autonomy to determine policy outcomes in this area. Another reason for the issue's low political visibility is that the liberalization

of financial movements, unlike trade liberalization, did not negatively affect any specific societal group in an easily recognizable way; rather, its impact was largely at the less visible and more dispersed macroeconomic level.

The fifth explanation for the difference in state behavior with regard to trade and finance is that there is a relationship between the two. As policymakers noted in the early postwar years, a liberal international financial order is not necessarily compatible with a liberal international trading order. The Bretton Woods negotiators worried that speculative and disequilibrating capital movements would disrupt trade patterns and encourage protectionist pressures. Recent experience has to some extent borne out these fears. Many observers have attributed the increase in restrictive trade practices in the 1970s and 1980s to the globalization of financial markets. Robert Gilpin has argued that "as international finance has more tightly integrated national markets, states have responded by increasing the level of trade protectionism."[36] Similarly, Rimmer De Vries concluded in 1990 that "there is a certain tension in maintaining both free capital and free trade. The difficulty of repressing capital flows makes for a tendency to compensate ill effects by giving ground on free trade."[37] In this sense, the difference in state behavior in trade and finance lends strength to the assertion that different parts of a liberal international economic order are not necessarily compatible.

Chapter 9 presents three broad theoretical issues that arise from these five explanations of the differences between state behavior in trade and finance. First, as suggested by three of the explanations, states may be more likely to embrace an open, liberal order in some sectors of the international economy than in others because of inherent sector-specific characteristics. Such an order was easier to create and maintain in finance than in trade because of the unique mobility and fungibility of money, the relatively cooperative attitude of central bankers, and the low domestic political visibility of the issue of financial liberalization. Second, the leadership of the United States, Britain, and, more recently, Japan in promoting globalization suggests that "hegemonic" states do play an important role in the creation of a liberal international financial order.[38] Three qualifications of the traditional hegemonic stability theory must be mentioned, however: (1) U.S. hegemonic behavior in finance was driven by less benevolent objectives than predicted by some versions of the theory; (2) the Japanese and British roles can be understood only by allowing for "leads" and "lags" in hegemonic behavior; (3) the concept of hegemony must be differentiated by sector, because each state's hegemonic interest in financial openness did not correspond with its interests in trade. Third, the apparent incompatibility of liberal orders in trade and in finance suggests that IPE scholars should be careful when using the term "liberal international economic order" to describe the structure of the international economy as a whole in any given period.

This book builds on recent work by IPE scholars to provide a more synthetic political history of the globalization of financial markets in the postwar period. It presents three broad arguments. First, globalization cannot be seen as a direct product of the early postwar international economic order. Rather, throughout the 1940s and 1950s, states were committed to a restrictive financial order outlined at Bretton Woods because of the strength of an embedded liberal framework of thought, U.S. strategic goals in the cold war, and the perceived need to sacrifice financial liberalism in order to promote free trade and exchange rate stability. The

shortsightedness of the New York bankers in 1945–47 also helped undermine the one brief effort to construct a more open financial order in this period.

Second, advanced industrial states have played an important role in the globalization process since the late 1950s by (1) granting freedom to market operators, both through encouraging growth of the Euromarket in the 1960s and through liberalizing capital controls after the mid-1970s; (2) choosing not to implement more effective controls on capital movements in the early 1970s and in four instances in the late 1970s and early 1980s; and (3) preventing three major international financial crises, in 1974, 1982, and 1987. Their support can be explained by the political difficulties involved in implementing more effective controls and in preventing unilateral liberalization moves; the respective hegemonic interests of the United States, Britain, and Japan in creating and maintaining a stable, open international financial order; the growing influence of neoliberal advocates in international financial policymaking; and the existence of an increasingly sophisticated regime centered around the BIS and designed to prevent and contain international financial crises.

Third, states embraced a more open liberal international financial order at a time when they retained numerous restrictive trade practices for five reasons: (1) The mobility and fungibility of money ensured that the collective actions necessary to create and maintain an open trade order were less relevant in finance. (2) The BIS-centered regime drew strength from the fact that central bankers, unlike trade officials, exhibited many of the characteristics of transnational epistemic communities. (3) The United States, Britain, and Japan supported the globalization trend in finance particularly strongly because their power and interests in trade and in finance differed considerably. (4) Neoliberal advocates were able to exert strong influence in finance in part because of the low domestic political visibility of the issue of financial liberalization. (5) State behavior in trade and in finance may have been interrelated, thus reinforcing the early postwar view that free trade and free finance are not necessarily compatible.

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1. Statistics from Goldstein et al. 1993:24; Turner 1991:9–10. Unless otherwise indicated, all amounts are in U.S. dollars.

2. Wriston 1988:71. See also McKenzie and Lee 1991, Bryant 1987, O'Brien 1992, and Al-Muhanna 1988.

3. Pauly 1988:2. See also Goodman and Pauly 1990.

4. Frieden 1987:166.

5. Strange 1986:29. Other IPE scholars who have begun to emphasize the key role of states in the globalization process include Cerny (1989), Cohen (1986), Hawley (1984, 1987), Kapstein (1989, 1992), Loriaux (1991), Maxfield (1990), Moran (1991), Rosenbluth (1989), Spero (1980), Underhill (1991), Banuri and Schor (1992), Dale (1984), Versluysen (1981), and Wachtel (1986). Many IPE scholars writing on international monetary issues, such as Aronson (1977), Gowa (1983), Kelly (1976), and Odell (1982), have also touched on the globalization of finance. The importance of states has also been discussed in Several other works on the globalization of finance, such as Mendelsohn 1980 and Hamilton 1986.

6. Volcker and Gyohten 1992:288.

7. Ruggie 1982.

8. Milward 1984.

9. Loriaux 1991, Ikenberry 1989, Maxfield and Nolt 1990, and Burnham 1990.

10. Quoted in Gardner 1980:76.

11. Gardner 1980:76.

12. Gilpin 1987:367. See also the discussion in Chapter 9 of this volume.

13. Krause 1971:536.

14. Loriaux 1991:chap. 4, 300–303.

15. Krause 1971:525.

16. For example, Gardner 1980:217.

17. Krasner and Thomson 1989:203.

18. Quote from Strange 1990:264.

19. Wrist on 1986:133.

20. The original G-10 countries were the United States, Canada, Japan, the Federal Republic of Germany, France, Italy, the United Kingdom, Sweden, the Netherlands, and Belgium. Switzerland also joined the G-10 after its formation, although the group's name remained unchanged.

21. Other scholars have also pointed to the competitive deregulation dynamic in finance, such as Goodman and Pauly (1990), Cerny (1989), Hawley (1987:142–43), Moran (1991), Plender (1986–87:41), Strange (1988:108), Walter (1991:207, 232), Hamilton (1986), Dale (1984:40), Kapstein (1989:324), and Bryant (1987:139).

22. See, for example, Gilpin 1987; Calleo 1982, 1987; and Strange 1988. The distinction between predatory and benevolent hegemony is from Gilpin 1987:90, 345.

23. For a discussion of "structural power," see Strange 1988:24–31 and Moran 1991:131.

24. This argument concerning U.S. behavior is somewhat similar to that of Walter (1991).

25. Krasner (1976:341–43) developed the notion of "lagging" hegemonic financial policy.

26. Ineham 1984.

27. Other scholars, such as Pauly (1987a, 1988), Schor (1992:8), and Plender (1986–87:40), also emphasize the importance of changing normative frameworks in explaining the increasing support of states for financial openness in the 1970s and 1980s.

28. The transnational spread of the earlier Keynesian revolution is well analyzed by Hall 1989.

29. The reasons given for the support of private financial firms and multinational industrial interests for neoliberal ideas in the 1970s and 1980s suggest that there is some validity to the argument that market pressures (such as increased financial competition and the growth of multinational corporations) can explain the globalization process. Whereas some see such pressures as promoting globalization *directly*, however, I am arguing that the influence was *indirect*; the support of neoliberal advocates by private financial firms and multinational corporations encouraged states to turn away from the restrictive Bretton Woods financial order.

30. My emphasis on this neoliberal coalition, as well as its earlier embedded liberal counterpart, is comparable to Maxfield's (1990) discussion of two competing "policy alliances or currents." Frieden (1991:442) also discusses the importance of distinguishing "two camps": "integrationist" forces, consisting of "the financial sector, owners of financial assets, and integrated multinational firms"; and "anti-integrationist" forces, consisting of "firms specific to a particular industry and location" (see also Frieden 1987:166–70). See also Goodman and Pauly 1990. Similarly, Moran (1991:12, 130–31) points to the importance of a common "bloc" of financial officials and private financial interests promoting globalization in each country. Pringle (1989) and Epstein and Schor (1992) also emphasize the centrality of financial interests.

31. For a discussion of the concept of a "regime," see Keohane 1984 and Krasner 1983.

32. Hirsch 1967:239.

33. See, for example, Dale 1984, Guttentag and Herring 1983:11–16, Kapstein 1989, Bryant 1987:chap. 8, and Spero 1980:185.

34. Haas 1992. Like Kapstein (1992), I am wary of describing central bankers as constituting a full-fledged transnational epistemic community, for reasons given in Chapter 9.

35. Duvall and Wendt (1987:46) and Bertrand (1981:21) have also commented on the low political visibility of international financial issues.

36. Gilpin 1987:367.

37. De Vries 1990:9.

38. Proponents of this view include Krasner (1976), Gilpin (1987), and Kindleberger (1973, 1986).