Explaining the globalization of financial markets: bringing states back in

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ABSTRACT

Many accounts of the globalization of financial markets over the past three decades explain it as a product of unstoppable technological and market forces. This article emphasizes that the behaviour of states was also of central importance in encouraging and permitting the process. States are shown to have supported financial globalization in three ways: (1) granting freedom to market actors through liberalization initiatives; (2) preventing major international financial crises; and (3) choosing not to implement more effective controls on financial movements. These roles are illustrated historically through a description of five sets of episodes since the late 1950s. States are found to have increasingly embraced the globalization trend because of: a competitive deregulation dynamic, political difficulties associated with the implementation of more effective capital controls, the ‘hegemonic’ interests of the US and Britain, the growing domestic prominence of neoliberal advocates and internationally-oriented corporate interests, and the unusually cooperative nature of central bank interaction.

KEYWORDS

Finance; globalization; states; money; liberalization; capital.

The globalization of financial markets over the past three decades has been one of the most spectacular developments in the postwar global political economy. Since the 1960s, cross-border movements of private capital have grown from almost nothing to a volume where they now dwarf international trade flows. This development has been all the more striking when it is recalled that the ‘constitution’ of the postwar international monetary and financial order – the Bretton Woods Agreement – strongly endorsed the use of capital controls. The Bretton Woods architects had explicitly sought to prevent global financial markets from reasserting the dominant role they had held in the global political

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economy in the decades before the 1931 international financial collapse (Helleiner 1993).

Discussions of the globalization of financial markets often explain it as a product of unstoppable technological and market forces. In the words of Walter Wriston:

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 . . . It was built by technology . . . (by) men and women who interconnected the planet with telecommunications and computers.

(Wriston 1988: 71)

Although technological and market forces were important, this dismissal of the role of political choices and state behaviour seems simplistic to a student of international political economy (IPE). At the very least, as Morgan Guaranty’s vice-president, Rimmer De Vries reminded the US Congress in the early 1970s, it is clear that ‘every participant in the [international financial] market . . . is a resident of some country and thus falls under the control or potential controls or supervision of its monetary authorities’ (US Congress 1971: 4).

In recent years, a growing number of IPE scholars have begun to demonstrate the specific roles played by states in the globalization of finance. To date, however, there has been no synthetic ‘political’ history of the globalization of financial markets that explains exactly how and why states were important to the overall process. After briefly explaining why little private international financial activity existed in the period between the 1930s and late 1950s, I sketch the outlines of such a history in this article.1 I argue that states can be seen to have played three key roles in the globalization process: (1) granting freedom to market actors through liberalization initiatives; (2) preventing major international financial crises; and (3) choosing not to implement more effective controls on financial movements. These three roles are illustrated through a brief description of five sets of historical episodes over the last three decades. The article concludes by summarizing the factors that explain the growing enthusiasm of states for the financial globalization process: a competitive deregulation dynamic, political difficulties associated with the implementation of more effective capital controls, the ‘hegemonic’ interests of the US and Britain, the growing domestic prominence of neoliberal advocates and internationally-oriented corporate interests, and the unusually cooperative nature of central bank interaction.
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THE MID-CENTURY ORDER: A WORLD WITHOUT PRIVATE GLOBAL FINANCE

It is important to note that from a long historical perspective there is nothing unusual about the existence of international financial markets. Bankers in eighteenth century Amsterdam or nineteenth century London, for example, moved enormous sums of private financial capital around the world with a level of expertise similar in many ways to their present-day counterparts. Indeed, the financial sector has traditionally been the most internationalized sector of economic life. What was unusual, however, was a period – one might call it the ‘mid-century order’ – lasting from the 1930s until the late 1950s when there was little private global financial activity. To understand the politics involved in the re-emergence of global finance, it is necessary first to look at why private global financial activity was so limited in these mid-century years.

One explanation concerns the behaviour of market actors. In the wake of the international financial crisis of 1931, private financial operators lost confidence in the safety and profitability of international financial activity. The economic and political upheavals of the next two decades then did little to restore it. The emergence of cartelized domestic financial structures across the advanced industrial world in the 1930s also bred a kind of inward-looking financial conservatism that discouraged interest in international financial activity among market actors.

State behaviour was equally important in inhibiting international private financial activity in the mid-century years. In the decades before the 1930s, a largely liberal order had existed with respect to the international movements of private finance. When capital controls had been used, they had always been employed in a limited and temporary fashion and generally for the strategic purpose of preventing unfriendly states from borrowing in domestic capital markets. In the wake of the 1931 international financial collapse, and particularly after the outbreak of the Second World War, this liberal regime collapsed. States began to experiment with increasingly comprehensive systems of capital controls, and such controls came to be seen as a permanent feature of their foreign economic policies. The new financial interventionism was then confirmed by the 1944 Bretton Woods Agreement which granted countries the explicit ‘right’ to use capital controls. Following this lead, almost all advanced industrial states employed extensive capital controls throughout the early postwar years. Even US policymakers, who did not employ capital controls in the 1940s and 1950s, were remarkably accepting of the use of capital controls abroad. They made little effort in these years to encourage financial liberalization in Japan and Western Europe. Moreover, when European governments finally restored the
convertibility of their currencies in 1958, the US also fully supported their decisions to restrict this convertibility to the current account.²

Why were states across the advanced industrial world so sceptical of the virtues of a liberal international financial order in this period? The widespread enthusiasm for capital controls was largely a product of a kind of structural break in financial affairs which took place in the wake of the financial crises of the early 1930s. Discredited by the crises, the private and central bankers who had dominated financial politics before the 1930s were increasingly replaced at the levers of financial power by a new class of professional economists and state managers whose social base was among labour and national industrial leaders. In place of the bankers’ laissez-faire ideology, these new social groups favoured more interventionist policies that would make finance the ‘servant’ and not the ‘master’ of political and economic life (Helleiner 1993).

The chief negotiators at Bretton Woods, John Maynard Keynes and Harry Dexter White, both representatives of this new class, explained particularly well the two central reasons why controls on international capital movements were now seen as necessary. First, as Keynes put it, ‘massive sweeping and highly capricious transfers of short-term funds . . . constituted a major source of damage to the international monetary system’ (quoted in Bloomfield 1946: 687–8). Such capital flows would need to be controlled if a stable set of exchange rates was to be maintained. Second, capital controls were needed to prevent speculative international financial movements from disrupting the policy autonomy of the new Keynesian welfare state. Keynes, for example, noted that: ‘the whole management of the domestic economy depends on being free to have the appropriate rate of interest without reference to the rate prevailing elsewhere in the world. Capital control is a corollary to this’ (Keynes 1980: 148–9). Similarly, White argued that capital flight motivated by political reasons or by the desire to escape the ‘burdens of social legislation’ had to be prevented from operating ‘against what the government deemed to be the interests of any country’ (Horsefield 1969: 31–2, 67). Although both acknowledged that capital controls would interfere with desirable ‘productive’ and ‘equilibrating’ capital movements, this was seen as the necessary cost of protecting stable exchange rates and especially the welfare state from speculative and ‘disequilibrating’ flows. In this sense, ‘embedded liberalism’ (Ruggie 1982) in the financial sphere was tilted heavily in the ‘embedded’ direction.

HOW DID WE GET FROM THERE TO HERE? FIVE SETS OF EPISODES

Many explanations of the re-emergence of global finance from this restrictive mid-century order stress the role played by technological and
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market factors. Technological developments, especially the growth of global telecommunications networks, are shown to have dramatically reduced the costs and difficulties involved in transferring funds globally. Important market developments are said to include: the restoration of private confidence in international financial transactions in the late 1950s; the growth of multinational corporations from the 1960s onwards; the response of market actors in the 1970s to the introduction of the floating exchange rate system and the 1973 oil price rise; and finally the competitive pressures emerging out of the unravelling of domestic cartelized financial structures across the advanced industrial world in the 1970s and 1980s.

According to these accounts, states have played a marginal role in the overall globalization process. They are said to have been forced to accept these technological and market pressures because of the enormous difficulties involved in controlling international movements of finance, difficulties that stem from the fact that finance is the most easily disguised and inexpensive of commodities to transport. Technological developments and increased economic integration in recent years are said to have only multiplied the channels for evasion for market operators. It has, thus, become common to argue that the endorsement of capital controls in the Bretton Woods Agreement was largely useless in that it misjudged the ability of states to control financial movements.

In this section, I argue that this attempt to diminish the importance of states needs to be challenged. I suggest that states can be seen to have played three central roles in the globalization process. First, they gave market actors much more freedom to operate than they would otherwise have had by liberalizing and removing barriers to the international movement of private financial capital. Second, through international lender-of-last-resort activities and international prudential regulation and supervision, states played a crucial role in containing and preventing international financial crises, crises which might otherwise have brought down the emerging global financial order. Third and most controversially, I argue that states might have tried to control capital movements more effectively than they did. This last point requires a brief elaboration. Although it is true that there are many difficulties in controlling financial movements, it is worth noting that Keynes and White argued that these could have been overcome in one of two ways: (1) through the use of comprehensive exchange controls in which all international transactions were monitored for illegal financial flows or (2) through cooperative measures in which all states agreed to cooperate in enforcing each other's capital controls. Both of these mechanisms, albeit in a somewhat watered down form, found their way into the final Bretton Woods Agreements (Helleiner 1993), and an explanation must be found for why
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states chose to employ them in an effort to render their capital controls more effective.4

The three roles that states played in supporting the globalization process can be highlighted by outlining five sets of episodes in the last three decades.

1 Early support for the Euromarket from the US and Britain

The first – an episode in which market actors were granted an extra degree of freedom – involved the support provided by certain states for the emergence of the Euromarket in the 1960s. Since the history of the market has been explained in detail elsewhere, it is necessary only to recall briefly several central points. Created in London in the late 1950s, the market acted as the key locus for international financial transactions in the 1960s largely because, in a world of widespread capital controls, it represented the one location where international financial operations could be conducted relatively freely. Transactions could be made in non-local currencies, especially the dollar, completely free from state regulations. Although this ‘offshore’ activity remained strictly segmented from national financial systems, it still represented the most liberal international financial environment that market actors had experienced in several decades and they quickly took advantage of it.

Despite frequent claims to the contrary, the Euromarket was not a ‘stateless’ market. Rather, its existence was heavily dependent from the outset on state support, particularly from the US and Britain. The importance of the British state was that it refrained from imposing regulations on Euromarket activity in London. In fact, it actively encouraged the market’s growth on British soil through various regulatory and tax changes (Kelly 1976). The support of the British state had its roots in that country’s hegemonic past. Although Britain’s international financial position had declined dramatically since its days as a financial hegemon in the nineteenth century, British financial authorities remained wedded – in a kind of hegemonic ‘lag’ – to the notion that London should act as a global financial centre after the Second World War.5 With capital controls needed on sterling to defend Britain’s weak balance of payments position and its postwar commitment to Keynesian macroeconomic policies, London’s role was initially limited to acting as a financial centre for the sterling bloc. By the late 1950s, however, as it became clear that the controls would stay in place, London bankers began to deal in dollars in order to capture international business without being constrained by sterling controls. The Bank of England quickly gave this new Euromarket activity its full support through a number of regulatory initiatives, seeing it as a way to combine London’s international role with Britain’s diminished economic position.

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The support of the US state was equally important because of the dominant role of American banks and corporations in the market in the 1960s. Although it had the power, the US state chose not to prevent them from participating in the market. By the mid-1960s, US officials were in fact actively encouraging US banks and corporations to move their operations to the offshore London market. There were two distinct reasons for the US support of the Euromarket. The first stemmed from a desire of US officials to preserve their policy autonomy in the face of growing US external deficits. From the early 1960s, US officials had tried to postpone the need for adjustment to the external deficits by persuading foreigners to finance them through dollar holdings. Although US officials introduced various incentives to increase the attractiveness of dollar holdings, in the end it was the appearance of the eurodollar market which proved particularly helpful. The market encouraged investors to hold dollars because it was freer and more liquid that most other financial markets of the time and because the unregulated interest rates on dollar holdings offered in the Euromarket proved much more attractive to foreigners than those available in the regulated US financial system. The importance of the Euromarket in increasing the attractiveness of foreign dollar holdings was recognized early on by US officials, and it became an important basis for US support of the market’s growth in the 1960s (De Cecco 1987: 187; Strange 1971: 209).

The second reason for US support for the Euromarket emerged after 1963 when the US government chose to introduce a capital controls programme as a means of reducing the deficit. Although the US had supported the use of capital controls abroad in the 1940s and 1950s, the programme marked the first attempt by the US government to introduce such controls at home in the postwar period and it provoked strong opposition from US banking and multinational industrial leaders whose international operations were constrained under the programme. Although they had little success repealing the controls during the 1960s, these businesses were able to find in the Euromarket some temporary relief from their problems. New York bankers could retain their dominant place in international finance by moving their dollar operations to London. American industrial multinationals could finance their overseas operations in the London market unencumbered by the US regulations. By the mid-1960s, the Johnson administration, as well as US Congress, were actively supporting this move offshore, seeing it as a way by which ‘national interest and corporate interest could be reconciled’ (Strange 1981: 698).

2. A failed cooperative control initiative in the early 1970s

Whereas the key role of states in the 1960s was that of providing market actors with a greater degree of freedom, the second important political
development involved their failure to implement cooperative capital controls of the kind outlined at Bretton Woods. The creation of the Euromarket, in addition to technological developments and increased economic interdependence, led to a rapid growth in international financial movements in the 1960s. Just as Keynes and White had predicted, the growth of private international financial activity brought with it large speculative financial flows that proved disruptive of the Bretton Woods fixed exchange rate system. By the late 1960s, in face of growing speculative flows, West European governments and Japan made clear their preference for maintaining the stable exchange rate system through the means of returning to a more controlled financial order. At first, in the late 1960s, and particularly following the suspension of dollar convertibility in August 1971, they focused on strengthening their domestic capital controls to preserve existing exchange rate values. It quickly became apparent that limited unilateral capital controls would not be sufficient. Evasion through leads and lags in current account payments could likely be curtailed unilaterally only with very draconian exchange controls of a kind which they were not willing to employ in the increasingly interdependent world economy of that period. Moreover, speculation in the offshore Euromarket could be prevented only with the help of other states.

When enormous speculative pressures forced the Europeans and Japanese to float their currencies in early 1973, they began to press for the second mechanism outlined by Keynes and White at Bretton Woods to effectively control finance: cooperative controls. While much has been written about the international monetary reform talks in this period, little attention has been paid to these proposals despite the importance given to them by participants at the time. In the crucial 1973 discussions in the Committee of Deputies of the Committee of Twenty, for example, European and Japanese officials actively pushed for the powers of the IMF to be extended in order to allow it to force states to cooperate in controlling financial movements. Such cooperation would involve not just the sending and receiving countries, but also ‘throughflow’ countries where Euromarket activity was located (IMF 1974: 85; Helleiner 1994: 102–11). The proposals also found strong support among the IMF staff who felt ‘that disruptive capital movements were the single most important cause of the collapse of the Bretton Woods system’ (quoted in De Vries 1985: 192).

The proposals for cooperative action were, however, blocked by US opposition. Although the US was completely isolated during the reform talks on the question of capital controls – an isolation that one internal US government memo at the time admitted ‘makes us appear irresponsible’ (quoted in Helleiner 1994: 109) – the proposals could not succeed without US approval because of the importance of US financial markets.
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and financial institutions in international financial activity. The US stance reflected a new liberal approach toward international financial movements in American foreign economic policy. In addition to opposing the European and Japanese proposals, the US in fact tried to use the reform talks to insist that foreign countries begin to dismantle their capital controls in order that a fully liberal international order be created. The new US financial liberalism was also demonstrated in two other important ways in this period. First, at the height of the currency crisis in early 1973, it announced that its own capital controls programme would be abolished the following year. Second, in the wake of the oil price rise, the US strongly opposed proposals from West European governments and the IMF that recycling of OPEC petro-dollars take place through IMF channels. The US position ensured that petrodollars would be recycled through the international private banking system rather than through public international institutions. In the words of the British Chancellor of the Exchequer Dennis Healey, ‘the Americans were bitterly opposed [to the proposals] because it would have meant interfering with the freedom of the financial markets’ (Healey 1989: 423).

There were two reasons for the new financial liberalism in US foreign economic policy in this period, each of which can be seen to have had their roots in US support for the Euromarket in the 1960s. First, US officials realized that the emerging open, liberal international financial system would help preserve US policy autonomy. Speculative international financial movements were central to the strategy of ‘talking down the dollar’ as a means of indirectly forcing Europe and Japan to bear the burden of adjusting to US external deficits. Market pressures would achieve what direct negotiations could not: a revaluation of European and Japanese currencies (Odell 1982: 191–9; Conybeare 1988: 248–9). Over the longer run, US officials also recognized that a more liberal international financial system would preserve the privileged global financial position of the US at a time when the Japanese and Europeans hoped to negotiate a more ‘symmetrical’ regulated international financial order. This was because New York financial markets and the eurodollar market remained by far the most attractive markets for private investors around the world. If market actors were given the freedom to invest globally, their investment choices would secure the dollar’s central international role and help the US to continue to fund external and internal deficits with foreign funds (Helleiner 1994: 113–15). Indeed, the pattern of OPEC investment after 1973 confirmed these predictions (Mattison 1985). In this way, the basis of American hegemony was being shifted from one of direct power over other states to a more market-based or ‘structural’ form of power.6

The new liberal stance toward capital movements in US policy was also related to a domestic political shift within the US. During the
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Nixon and Ford administrations, prominence was given in international financial policy to figures who strongly rejected on ideological grounds the restrictive embedded liberal approach to financial movements that had inspired the Bretton Woods order. These ‘neoliberals’ – inspired by Friedrich Hayek and Milton Friedman – praised the role of market forces in promoting an efficient allocation of capital not only internationally but also within domestic financial systems. They also opposed capital controls on the grounds that such controls represented a use of coercive ‘police power’ by the state that was incompatible with a ‘free’ form of government and individuals’ freedom to move their money where they pleased. Moreover, neoliberals took issue with the two reasons outlined at Bretton Woods as justifying capital controls. First, they rejected the postwar concern that speculative financial flows would disrupt stable exchange rate arrangements by arguing strongly in favour of a floating exchange rate system. Second, they did not sympathize with the commitment of Keynes and White to national Keynesianism and the autonomy of the welfare state. Instead, they applauded the way international financial markets would discipline government policy and force states to adopt more conservative, ‘sound’ fiscal and monetary programmes.

The sudden prominence of neoliberal thinkers in US international financial policy-making circles in the early 1970s was partly related to the way that their views on the desirability of a liberal financial order dovetailed perfectly with the ‘national interest’ concerns outlined above. Equally important, however, was the broad unravelling of the coalition within US politics which had supported the earlier embedded liberal approach. In particular, industrial leaders who had been sympathetic to capital controls in the early postwar period had become frustrated in the 1960s with the way US and foreign capital controls increasingly infringed on their growing multinational activities. As early as the mid-1960s, they were beginning to support neoliberal thinkers and financial interests who had been promoting a more favourable view of financial liberalism throughout the postwar period. By the early 1970s, they had become strong proponents of the neoliberal message and their voices found considerable influence in the Nixon and Ford administrations.

3 Three failed regulatory initiatives in the late 1970s/early 1980s

The failure of the European and Japanese initiative to move back towards a more closed financial order marked the collapse of the first principle established at Bretton Woods: that financial movements should be controlled in the interests of preserving a stable international exchange rate system. It had been hoped by many that the floating exchange rate system would grant states considerable policy autonomy from external market pressures. The increasing flows of speculative capital, however,
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to that the system of floating exchange rates, far from insulating the domestic economy, often subjected it to new pressures. Not only did the same problems of trying to retain monetary control in an open global financial system remain, but also ‘vicious circles’ of disequilibrium afflicted countries pursuing expansionary policies in which the depreciation of the country’s currency would reinforce domestic inflationary pressures, thus further undermining confidence. These pressures forced policymakers to a second choice: whether or not to give up the second principle of the Bretton Woods order, the commitment to policy autonomy.

In the late 1970s/early 1980s, there were three key turning points when state officials gave serious thought to trying to restore more effective controls over capital movements in the interest of preserving policy autonomy. These involved the UK in 1976, France in 1983, and the US in 1979–80. In each case, initiatives to move back to a more controlled international financial order failed. Had they succeeded, however, the globalization trend might have been considerably set back. Although the episodes are well known to international financial specialists, their importance as crucial ‘non-decisions’ is often neglected in histories of the globalization process.10

The first major turning point involved Britain in 1976 (Fay and Young, 1978; Burke and Cairncross 1992). After borrowing extensively in international financial markets in 1974–75 to finance a domestic economic expansion, British authorities suddenly found the markets speculating heavily against sterling in 1976. A vicious circle of disequilibrium quickly emerged in which sterling’s depreciating value reinforced domestic inflationary pressures that in turn only further undermined confidence in sterling. The currency crisis forced the Labour government to a difficult choice. On the one hand, winning back the confidence of the international markets would require giving up its domestic expansion and accepting an austerity programme being advocated by the IMF and the international financial markets. On the other hand, preserving policy autonomy would require insulating the domestic economy from external financial market pressures with the kind of draconian exchange controls outlined by Keynes and White at Bretton Woods.

Faced with these choices, a serious split emerged within the government. Initially, there was considerable support for the latter option. At the Labour Party conference in September, for example, this ‘Alternative Economic Strategy’ was passed as party policy and a resolution was approved calling for an investigation into ‘ways in which the buying and selling of sterling and foreign exchange can be taken out of the hands of private firms in the City of London’ (Labour Party 1976: 308). Two factors, however, led the Cabinet to reject this strategy and adopt the IMF’s austerity package in December. First, it was thought that the costs associated with a regime of rigid exchange controls would be very
high. Given Britain’s extensive international economic linkages, there would be enormous domestic economic disruption. Prime Minister James Callaghan (1987: 441) also noted that there would be ‘serious implications for our relations with the GATT, the European Community and NATO, as well as the US’. Second, the stagflationary environment of the 1970s had encouraged an increasing disillusionment with Keynesianism and ‘embedded liberal’ frameworks of thought among key members of the government. Chancellor Healey, in particular, had given up on Keynesianism and had become a strong advocate of austerity (Healey 1989: 378–9). Many of his key advisors in the Treasury and Bank of England, in addition to influential private bankers in the London markets, had also embraced neoliberal frameworks of thought, often under the influence of US-based neoliberals such as Friedman as well as institutions such as the Institute of Economic Affairs which had been founded under Hayek’s leadership in the 1950s (Healey 1989: 412–3, 426–7, 430, 434; Fay and Young 1978: 10, 14, 22, 24).

The decision to accept the discipline of international financial markets was a central one for British politics. As Joel Krieger (1986: 58) notes, it ‘signified the end of Keynesian society in Britain. Thatcherism was soon to follow’. It was also a key turning point for the global financial system as a whole. Britain had played a vital role in promoting the reemergence of an open global financial system, and it would continue to do so in the 1980s. Had the British Cabinet chosen to close down London’s position as an international financial centre, the embryonic global financial system would have been dealt a strong blow. As the US Secretary of State at the time noted: ‘it was a choice between Britain remaining in the liberal financial system of the West as opposed to a radical change of course . . . I think, if that had happened the whole system would come apart . . . So we tended to see it in cosmic terms’ (quoted in Fay and Young 1978: 5).

The French experience of 1981–83 provided the second important turning point (Bauchard 1986). Elected in May 1981, the new Mitterrand government was strongly committed to a national Keynesian expansion to bring France out of its recession. From the outset, however, it found itself constrained by speculative activity against the franc in international financial markets. After two devaluations within the European Monetary System (EMS) failed to stem speculation, the Mitterrand government split in early 1983 along the same lines as Britain’s Labour government had in 1976. One group of senior advisors advocated leaving the EMS and introducing tight exchange controls in order to maintain the expansion. Opposed to them was a group led by Finance Minister Jacques Delors who had become advocates of a more neoliberal solution to France’s economic woes involving monetary discipline and market liberalization. Although Mitterrand initially sided with the former group
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after a disastrous municipal election in early March, thereby plunging
the government into chaos, he quickly became persuaded of the
enormous political and economic costs – both domestically and inter-
nationally – that would be associated with a ‘seige’ economy. By mid-
March, the government had chosen the deflationary course, abandoning
its earlier Keynesian programme and accepting the discipline of the
markets.

The dramatic ‘U-turn’ of the Mitterrand government was an impor-
tant moment for the globalization process in several ways. Within
France, the embedded liberal framework of thought with which the
Mitterrand government had come into office was rejected overnight in
favour of a more neoliberal approach. Market liberalization, especially
in the financial sector, and monetary discipline became key policy goals
(Loriaux 1991; Cerny 1989). The French experience also resonated beyond
its borders. France soon became an important advocate of the pan-
European neoliberal project that was led by Delors in his new capacity
as European Commission President. Equally important, for many on
the left around the world who had closely followed the Mitterrand
experiment, the French experience signalled the enormous difficulties
involved in preserving the ‘old world’ of embedded liberalism in the
new global financial environment.

The third significant turning point in the late 1970s/early 1980s
involved the failure of an initiative by the US Federal Reserve to regu-
late the Euromarket in 1979–80 (Hawley 1987: ch. 7). Whereas the British
and French governments had sought to defend expansionary Keynesian
policies from international financial discipline, the US Federal Reserve
was concerned in this period about the way US banks and corporations
were evading its restrictive monetary policy by borrowing dollars in the
offshore Euromarket, a market that had grown to be as large in size as
10 percent of the US M-3 money supply by 1980. To deal with this
growing threat to its policy autonomy, the US Federal Reserve decided
to try to reduce the market’s size by introducing reserve requirements
on Euromarket activity. These regulations would, it was hoped, both
reduce the market’s attractiveness and bring its regulatory structure in
line with bank regulation in the US.

To be effective, however, this initiative required the cooperation of
other central banks. A unilateral imposition of reserve requirements on
US financial institutions operating offshore would only have had the
effect of driving Euromarket activity into foreign bank hands. Conse-
quently, the Federal Reserve began to press other G-10 central
banks in 1979–80 to consider a proposal whereby each central bank
would impose reserve requirements on their own bank’s Euromarket
activities. The proposal was defeated, however, by opposition from
Britain and Switzerland at a May 1980 meeting. As Euromarket centres,
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these states had the most to lose from any effort to reduce the attractiveness of the market. The proposal had also met with considerable opposition at home from the US banking community who were demanding instead a deregulation of US banking laws to meet the lax rules in the Euromarket. Indeed, their demands were largely met not only with the passage of the 1980 and 1982 bank deregulation packages, but more importantly with the introduction on US soil of regulation-free International Banking Facilities (IBFs) in December 1981. After the defeat of their reregulatory initiative, the Federal Reserve had agreed to the introduction of IBFs simply in order ‘to make the best of a bad Euro-currency situation’ (Hawley 1987: 139). Although they would further disrupt the management of domestic monetary policy, the IBFs would after all bring Euromarket business to the US, thereby raising ‘the share of American banks in international finance’ (Dale 1984: 30).

The failure of the Federal Reserve’s initiative was important in several ways. To begin with, had the initiative succeeded it could have considerably slowed the momentum that grew in the 1980s in favour of the deregulation and liberalization of financial markets across the advanced industrial world. Competitive pressures from the Euromarket, as well as from the deregulating US financial system, would play a major role in promoting financial reform elsewhere in the 1980s. Second, it confirmed a lesson learned in the early 1970s that the cooperative mechanisms of restoring control over international financial markets advocated by Keynes and White at Bretton Woods were easily scuttled by the opposition of states who derived benefits from financial openness. Finally, it demonstrated that the desire to preserve policy autonomy from financial openness was not restricted to those pursuing expansionary Keynesian policies. Central bankers too had emerged from the mid-century order committed to macroeconomic management, albeit of a more conservative type, making them also somewhat wary of financial openness.

4 Liberalization decisions in the 1980s

These three failed initiatives to reregulate global financial markets set the stage for the fourth key political development in the globalization process: a flurry of liberalization moves in the 1980s. During the 1980s, governments across the advanced industrial world abolished external capital controls which had been in place for half a century giving market actors a degree of freedom unparalleled since the 1920s. Indeed, by the end of the decade, an almost fully liberal order had emerged across the OECD region. The restrictive Bretton Woods financial order outlined by Keynes and White had been effectively abandoned.

The US and Britain were the leaders of this trend to dismantle restric-
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tions on the international movement of private financial capital. As we have seen, the US had already abolished its capital controls in 1974. After the events of 1979–80, however, US policymakers became even more active proponents of financial liberalization. In addition to introducing IBFs in 1981, they abolished the withholding tax on foreign holdings of US bonds in 1984 and issued special Treasury bonds directly into the Euromarket for the first time in the same year. Moreover, US Treasury officials also began to press foreign states to liberalize their capital controls after 1983. They played a particularly significant role, for example, in encouraging Japanese policymakers to begin to liberalize their regime of capital controls during the 1980s, a regime that had been among the most comprehensive in the OECD region throughout the postwar period. As Destler and Henning (1989: 29–30) note, US enthusiasm for financial openness after the early 1980s stemmed largely from the realization that, as in the 1960s and early 1970s, a more open and liberal global financial order could play a major role in financing the large US budget and current account deficits that emerged after 1982. US officials predicted accurately that internationally mobile funds would be attracted by the unique depth of US financial markets and the international role of the dollar, as well as by the high US interest rates which emerged out of the combination of tight monetary policy and loose fiscal policy in the Reagan years.

Britain’s leading role in the financial liberalization trend stemmed from two decisions (Moran 1991: ch. 3). The first was the dramatic abolition of Britain’s forty-year old exchange controls by Margaret Thatcher’s new government in October 1979. Although the ground had been laid for this move by the Labour government’s handling of the 1976 crisis, it was the neoliberal orientation of the new Thatcher government which was central to this decision. Capital controls were viewed by the new government as both an unnecessary form of state intervention and a ‘substantial restriction on . . . individual liberty’. The abolition of exchange controls was also pressed by figures within the City of London who argued that full financial freedom was necessary for London to compete effectively with New York for international financial business. The latter concern was even more central in explaining the decision in 1986 to liberalize the London Stock Exchange and open it to foreign institutions. In an era when international financial activity was shifting away from banking to securities, this ‘Big Bang’ was seen as vital by British financial authorities for the London Stock Exchange to compete with the New York Stock Exchange which had been deregulated back in 1975.

The liberalization decisions in the US and Britain, as well as the broader deregulatory trends within their respective financial systems, played a major role in encouraging similar liberalization moves elsewhere in the
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OECD region in the 1980s (Moran 1991; Enkjo 1989; Strange 1990). Unless they matched the liberal and deregulated nature of the British and US financial systems, foreign financial authorities could not hope to attract new financial business and capital from abroad or even maintain the financial business and capital of their own multinational corporations or international banks. These competitive pressures encouraged the idea that the financial sector required an ‘industrial policy’ like any other sector to retain its competitiveness. In the financial sector, such a policy consisted of liberalization and deregulation decisions designed to appeal to and attract footloose international financial market operators. These competitive concerns were important, for example, in encouraging financial liberalization decisions across the European continent after the mid-1980s (Cerny 1989; Hamilton 1986), decisions that in turn laid the ground for the 1993 decision by the European Community as a whole to abolish all capital controls by mid-1990 (with a slightly later deadline given to Greece, Portugal, Spain and Ireland). Competitive pressures from the US and Britain also played an important role in prompting liberalization and deregulation in the Japanese financial system throughout the 1980s (Strange 1990; Rosenbluth 1989: ch. 5, 224) as well as the announcements in 1989–90 by the Scandinavian countries that they would eliminate their capital controls (Helleiner 1994: 165–6).

Countries across the OECD region were responding not just to external competitive pressures in liberalizing their capital controls in the 1980s, but also to new domestic political pressures. One of these was the growing domestic political prominence of advocates of neoliberal economic thinking during the 1980s (Helleiner 1994: ch. 7). Whereas capital controls had previously been a central element in national Keynesian and corporatist planning strategies, neoliberals were increasingly successful in convincing policymakers in the 1980s that such controls were defending outdated interventionist economic policies. New emphasis was placed across the advanced industrial world on the role that financial liberalization and deregulation could play in providing freedom for savers and investors as well as in enhancing the efficiency of the financial intermediation process both domestically and internationally.

The new political prominence of neoliberal advocates was partly a product of the broad disillusionment with ‘embedded liberal’ economic policies in the context of the economic troubles of the 1970s and 1980s. Equally important, neoliberal arguments in favour of financial liberalization were supported by financial firms as well as by multinational businesses in this period, both of whom saw capital controls as a cumbersome interference in their increasingly internationally-oriented activities (Frieden 1991; Goodman and Pauly 1993; Moran 1991: 12, 130–1). As had been true in the US in the early 1970s and Britain in the late 1970s, this
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alliance of neoliberal advocates and internationally-oriented corporate interests played a key role in prompting financial liberalization decisions across continental Europe, Scandinavia as well as the decisions of Australia and New Zealand to abolish overnight their extensive postwar capital controls in 1984–85. Financial and industrial firms with growing international ambitions in Japan were also important in encouraging financial liberalization in that country during the 1980s.13

5 Preventing international financial crises

In the four sets of political developments that have been outlined so far to explain this reemergence of global finance, the key role of states was that of either liberalizing capital controls or refraining from tightening them. A ‘political’ history of this reemergence of global finance would not be complete without outlining one further role of states in the process: that of preventing financial crises. Financial markets are especially prone to experience periodic panics because of imperfect information and the mobile nature of finance. At the international level, such panics can quickly shatter the confidence of market operators in the safety of cross-border transactions and destroy international financial markets. In particular, during international financial crises, private financial operators tend to retreat to the safety of domestic markets because of the lesser familiarity of foreign markets, the currency risks involved in international investment, and uncertainties regarding the issue of how states will treat foreign assets. The international financial crisis of the early 1930s provided a vivid example of this phenomenon.

It is widely recognized, however, that states can play a central role in preventing international financial panics, and thus preserving an open financial order, through lender-of-last-resort activity and through prudential regulation and supervision of financial markets. In Charles Kindleberger’s (1978: 4) words, states can provide ‘the public good of stability that the private market is unable to provide for itself’. At Bretton Woods, little attention was given to the need for these activities at the international level as few expected global financial markets to reappear. The growth of international banking in the 1960s and 1970s, however, raised the question of who would act to prevent a banking crisis from spreading rapidly through the nascent international markets.

The first major test came in 1974 with the collapse of the Herstatt and Franklin National Banks (Spero 1980). Because both banks had many outstanding foreign exchange contracts and held large deposits from other banks, their collapse threatened to trigger a serious panic in international banking markets. A financial panic was prevented for two reasons. First, the US Federal Reserve acted swiftly to assume the role of international lender of last resort in the crisis. It was particularly
concerned that the crisis might undermine confidence in the dollar and the US financial system (Spero 1980: 113–14), a confidence that was important to maintain given America’s centrality within the emerging global financial order and its increasing reliance on international financial support to fund its economic imbalances. The Federal Reserve was also greatly aided in this lender-of-last-resort role by cooperation from G-10 central bankers who shared a common desire to prevent instability in international financial markets. This cooperation was made particularly easy because of close links that had been established between G-10 central bankers within the Bank for International Settlements (BIS). The BIS had been created in 1929–30 with the goal of creating a forum in which international financial stability could be pursued in a pragmatic and depoliticized fashion (Costigliola 1972). Although it had failed to prevent the 1931 International financial collapse, the BIS had found new life in the 1960s as an institution where G-10 central bankers could meet and try to handle the growing currency turmoil of that decade. Its monthly meetings in this period helped rekindle a kind of ‘internationalism of central bankers’ dedicated to the task of preserving international financial stability. This sentiment had been largely dormant since the prewar period and the relationships between central bankers that developed during the 1960s proved helpful in handling the 1974 banking crisis (Spero 1980: 153).

The BIS also served as the forum in which discussions began in the wake of the 1974 crisis to create more formal arrangements aimed at preventing future crises. In September 1974, for example, a communiqué was issued by G-10 central bankers declaring that ‘means are available’ for lender-of-last-resort activities in international banking markets. Although it was unclear the extent to which lender-of-last-resort responsibilities had been formally defined, Jack Guttentag and Richard Herring (1985: 31) note that this statement did much to restore confidence in the international markets. Moreover, at the Bank of England’s instigation, a committee was created within the BIS in 1974 to study how more permanent arrangements could be established to reduce the risk of future banking crises. In 1975, the committee announced the Basle Concordat, a set of jurisdictional rules governing regulatory and supervisory activities in international banking markets.

The 1982 international debt crisis, triggered by Mexico’s declaration of default, was the second major crisis to strike the international financial system (Kraft 1984). More serious than the 1974 crisis, Mexico’s default threatened to bring down the entire international banking system at one stroke. Once again, the immediate crisis was avoided by a combination of US and BIS action. From the US, large credits were quickly extended to Mexico partly in the form of an advance on oil payments from the Department of Energy and partly as a loan from the Commodity
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Credit Corporation for the purchase of US agricultural products. Once again, the US action was driven by its stake in the crisis: the bulk of Mexican debt was held by American banks and the crisis threatened their stability as well as that of the dollar. The US funds were also supplemented by a $1.85 billion bridging loan from the BIS to the Bank of Mexico, of which the US Federal Reserve contributed approximately half. In the subsequent Brazilian and Argentine crises, the BIS central bankers acted decisively again to provide bridging loans needed to overcome temporary liquidity crises in these countries.

With the short-term crises handled, complex negotiations were initiated between all the major debtors and the international banking community to prevent further defaults. Although it is not possible to summarize this process in this article, the US Federal Reserve, the US Treasury and US bank regulators continued to play a central role facilitating the rescheduling agreements. Moreover, like the 1974 crisis, the international debt crisis acted as a catalyst for further strengthening supervisory and regulatory cooperation in international banking. In particular, it focused the attention of bank regulators on the need for healthy capital-asset ratios in international banking. The US Federal Reserve and the Bank of England took a particular leadership role in encouraging their central bank colleagues within the BIS to consider the introduction of a common capital adequacy standard for all banks under their jurisdiction. By 1988, an agreement had been reached which set 1992 as the deadline by which that standard would be introduced (Kapstein 1992). Even before its implementation, this agreement is said to have played a key role in ‘forcing more discipline into the banking markets.’

Although less serious than the 1982 crisis, the 1987 international stock crash also shook confidence in international financial markets. Whereas the 1974 and 1982 crises had affected banking markets, this crisis struck the growing international securities markets. In this episode, global markets were stabilized primarily through concerted BIS central bank intervention in the markets (Helleiner 1994: 184–5). As with the two previous crises, the crash served to focus attention on the need to extend supervisory, regulatory, and lender-of-last-resort cooperation to securities markets. The BIS played a major role in pressing for action in cooperation with the newly formed International Organization of Securities Commissions (IOSCO). By early 1992, there was agreement in principle between the BIS and IOSCO on a common worldwide framework for international capital rules for securities companies to match that existing in the banking field. As in the banking field, regulators from the US and Britain played a lead role in the negotiations (Porter 1993).

Without the decisive actions of states acting as lenders-of-last-resort to restore stability in the emerging global financial markets during each
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of these three crises, the globalization trend might well have lost much of its momentum. Indeed, even with the lender-of-last-resort action by the US, Britain and the BIS central banks, there was a considerable retreat from international financial markets by private operators in the wake of each crisis as they withdrew to the greater safety and familiarity of domestic markets. States also played an important role in seeking to minimize further instability in international financial markets through the various norms, rules and decision-making procedures they devised to facilitate their regulation and supervision of those markets. These can be seen as representing the emergence of an increasingly sophisticated ‘regime’ designed to preserve international financial stability of the kind that the Bretton Wood conference failed to set up.

CONCLUSION

The re-emergence of global finance over the past three decades was not a product solely of market and technological developments. Rather, as has been demonstrated in these five sets of episodes, state behaviour and political choices have also played an important role in the process. Why have states increasingly embraced and encouraged the globalization trend in the last three decades? In this conclusion, it is worth briefly summarizing the reasons.

First, states were partly encouraged to liberalize their existing capital controls because of a competitive deregulation dynamic. Through financial liberalization and domestic deregulation, governments sought to lure to their markets footloose financial business and capital which could provide such important benefits as employment, foreign exchange earnings and funding for current account and fiscal deficits. Financial liberalization and deregulation were the chosen policy tools to attract financial business and capital because states recognized that the mobility and fungibility of money made financial market operators display what Richard Dale (1984: 40) calls ‘unusual sensitivity to regulatory differentials between financial centres’. This competitive dynamic in the financial sector ensured that a closed financial regime such as that existing in the early postwar years was likely to unravel over time. Once a major state or group of states initiated the liberalization and deregulation of their financial markets, others would feel obliged to follow in order to avoid losing financial business and capital to them. In the postwar situation, the US and Britain played the key role in encouraging this competitive liberalization and deregulation process first through their support for the liberal, deregulated Euromarket in the 1960s, and then through their broader liberalization and domestic deregulation programmes in the 1970s and 1980s.

Second, states also increasingly accepted and embraced the globaliza-
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tion trend because the two mechanisms outlined at Bretton Woods for more effectively controlling capital movements proved politically difficult to implement. As became clear in the 1970s and early 1980s, states were unlikely to introduce unilateral comprehensive exchange controls because of the enormous economic and political costs associated with them in an increasingly interdependent world economy. More effective cooperative strategies for controlling finance were also difficult to implement because they could be easily scuttled by individual states exercising a veto, as the US showed in the early 1970s and Britain and Switzerland demonstrated in 1980. Indeed, it could be said that cooperative control initiatives were hampered by a classic collective action problem in that states were tempted to derive the benefits from a more closed international financial system (such as greater policy autonomy and more stable exchange rates), while ‘free-riding’ on that system by unilaterally liberalizing their markets in order to capture financial business and capital for their national financial system. The difficulties in preventing such behaviour provided a further reason why it was likely that the restrictive Bretton Woods financial order would unravel over time.

Third, the particularly strong support shown by the US and Britain for financial globalization was in large part a product of their unique ‘hegemonic’ interests in international finance. In the case of the US, we have seen how it explicitly encouraged the creation of more open, liberal international financial order as a means of exploiting its hegemonic position with that order, a position that resulted from the centrality of the dollar, US financial institutions, and US markets in the emerging open global financial order. This strategy began with the promotion of the Euromarket in the 1960s, followed through its stance in the reform talks in the early 1970s and culminated in its enthusiasm for financial liberalism during the Reagan years. In each instance, the US saw that its hegemonic position in the emerging open global financial order could be used to help finance its growing current account and fiscal deficits. In this sense, the US role in promoting financial globalization since the 1960s fits predictions of the ‘hegemonic stability theory’ that a state with a hegemonic position will seek to create and maintain an open and liberal order from which it benefits.15

The key British role in promoting the globalization trend can also be understood using a slightly modified ‘hegemonic’ model. The British support for the Euromarket, its enthusiasm for financial liberalization in the 1980s, as well as its role in promoting financial stability are best seen as products of a kind of hegemonic ‘lag’ in behaviour in which the British state remained ‘locked in’ to a commitment to financial leadership stemming from its days as a financial power in the nineteenth century. The ‘lag’ in finance endured after 1945 primarily because of the power of what Geoffrey Ingham (1984) calls a ‘Bank of England–
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Treasury–City’ nexus within British politics which favoured the promotion of London’s internationalism. It was also encouraged because of the way in which the Euromarket provided London with a mechanism by which to rebuild its leading position in finance.

Although ‘hegemonic interests’ may account for some of the reasons why the US and Britain showed a special willingness to promote financial globalization, these two states were also influenced during the 1970s and 1980s by the growing domestic political prominence of neoliberal advocates in the financial sector. A similar domestic development also was important in explaining the sudden commitment of other states across the advanced industrial world to financial liberalization during the 1980s. This new prominence of neoliberal advocates across the advanced industrial world partly reflected the growing disillusionment with ‘embedded liberal’ policies in the stagflationary environment of the 1970s and 1980s. Equally important, the neoliberal advocacy of financial liberalization was also supported by financial and industrial interests whose interests had become increasingly internationalized during this period. The growing domestic influence of coalitions of neoliberal advocates and internationally-oriented corporate interests across the advanced industrial world constitutes the fourth explanation of state support for the financial globalization process.

The fifth and final explanation concerns the role that G-10 central banks played in preventing international financial crises. In part, financial crises were prevented by the leadership behaviour of the US and to a lesser extent Britain, behaviour which stemmed in large part from their respective ‘hegemonic’ interests in financial openness. Equally important in preventing financial crises, however, was the behaviour of G-10 central bankers who demonstrated a keen interest in cooperating to preserve international financial stability. Ethan Kapstein (1992) has argued that their common belief in the need to stabilize global financial markets through lender-of-last-resort activities and international regulation and supervision as well as their strong commitment to cooperation suggests that G-10 central bankers shared some of the characteristics of what Peter Haas (1992) has termed ‘transnational epistemic communities’. In their pursuit of common policy projects to prevent financial crises, it is important also to note that the G-10 central banks were aided particularly by the existence of the BIS. Ironically, this was an institution which the Bretton Woods participants attempted to abolish in 1944 largely because of its association with the pre-1931 world of ‘haute finance’ that they sought to eliminate (Eckes 1975: 152–3). The resolution that called for the BIS’s elimination ‘at the earliest possible moment’ was, however, never enforced and the institution survived to play a major role in helping to preserve exactly the kind of private global financial order that the Bretton Woods architects opposed.
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Although I have emphasized the need to ‘bring states back in’ to histories of the globalization of finance in this article, two of the five factors explaining state behaviour highlight the need not to draw too large a distinction between ‘political’ accounts of financial globalization, such as that offered here, and those emphasizing technological and market factors. I have argued, for example, that a key reason why states in the 1970s and early 1980s chose not to introduce the kind of comprehensive exchange controls outlined by Keynes and White was that they perceived the costs associated with such controls to be too high in an increasingly interdependent world economy. Since growing interdependence was partly a function of technological and market developments, such developments have clearly encouraged financial globalization not only directly (by prompting private actors to engage in global financial operations) but also indirectly by encouraging state behaviour that further supported the globalization process. Similarly, I have suggested that a central factor explaining the decision of states to liberalize their capital controls in the 1970s and 1980s was domestic pressure from corporate interests whose operations had become increasingly internationalized. Once again, the internationalization of corporate activity was linked partly to technological and market changes, changes that can thus be seen to be encouraging financial globalization indirectly by creating domestic political constituencies that lobbied states to remove capital controls. In these ways, it is clear that state behaviour, market developments and technological change have interacted in complicated ways to encourage the financial globalization trend. In emphasizing the role played by states in this article, I have sought not to downplay the importance of market and technological factors but rather simply to stress one cause of the globalization of financial markets which has hitherto received less attention than it deserves.

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