Rethinking the Relationship of States and Financial Markets after the 2008 Global Credit Crisis

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ABSTRACT

Rethinking the Relationship of States and Financial
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This dissertation contends that an alternate conceptual framework—the "marketplace framework"—explains more clearly the nature of International Political Economy (IPE) as a field of study and as a set of global conditions and activities. It critiques the failure of the dominant IPE framework—what I call the "tension framework"—to effectively explain the process of evolution that led to the 2008 global credit crisis and the political reactions to the crisis itself. It argues that in order to understand those processes and reactions, we need to re-frame and re-analyze relationship of politics and finance in market framework terms.

The marketplace framework focuses on relations of advanced liberal capitalist states and their financial markets (as the most elemental units of their respective realms), instead of the broader state-market relations. It argues that understanding these particular relations is critical to the total conception of IPE because advanced liberal capitalist states and their financial market institutions constitute the axis of the global political economy.

The research draws upon the international capitalist experience in general and the development of financial capitalism in particular and investigates: 1.) why the advanced capitalist economy—finance and trade—is designated as a "self-regulating" realm

detached from the state; 2.) why the financial realm is "divorced" from the physical economy. It concludes that finance is a complex legal mystery and it is *separated* from politics and the physical economy in order to give the advanced liberal capitalist system its distinctive governing principle. The principle is that regardless of the self-regulating 'designation,' advanced capitalist system of governance *unnecessarily* isolates finance from the state because the former, in Weberian thought, is the *means specific* to the latter.

The dissertation is interdisciplinary and analytic in method as it is qualitatively historical and interpretive in approach. By analytic, I mean examining the relationship of "states" and "markets" at their most fundamental units. By interdisciplinary, I mean exactly what Robert Gilpin refers to as eclectic mixture of theoretical viewpoints and analytic methods. In brief, the dissertation seeks to provide an alternate framework for re-conceptualizing the multiple stories underway in contemporary IPE.

PREFACE

The dominant framework that has defined as well as shaped IPE in theory and practice remains a controversial topic. I call it the "tension framework" because it classifies states and markets—the major analytic units of IPE—into two governing spheres and analyzes their relationship as a parallel, mutually interactive and tension-packed phenomenon—a relationship of two autonomous institutions striving for power to organize society.

This dissertation research is an attempt to develop an alternate mode of thought that conceptualizes IPE in market framework terms. It began as an "unfinished draft" paper, which I presented at the 49th International Studies Association Annual Convention in San Francisco, in March 2008. It has taken a bit longer to complete primarily because of analytical and empirical implications of the ongoing global financial crisis, which began roughly six months after the conference. The crisis took the initial wind out of the research sails, and it had to be rethought and refocused with considerable regards for old and new macro-micro processes and events—with their embedded contradictions, uncertainties and ambiguities—endlessly resurfacing and becoming more proximate as much as they were complex to grasp. I finally pushed it to the fore when my primary advisor informed me he was going to retire from his 35-year distinguished career.

Completing it would not have been possible without institutional and individual support that I received, and for which I am very grateful. I would like to thank the Division of Global Affairs (DGA) for providing an enabling environment for my studies and for granting me teaching assistantship to pursue it. My thanks also go to Rutgers-Newark Graduate School for offering me dissertation fellowship for 2009/2010 academic year. I have no doubt that I would not be where I am in my academic pursuit without the financial support.

I would like to express my sincere thanks to Prof. Philip G. Cerny, the Chair of my Dissertation Committee, not only for his useful comments and suggestions towards this research, but for inspiring me with his research and teaching. My quest to understand the nature of IPE stems from his works. In the process, I have learned a lot from him and will continue to do so. My thanks also go to the other members of my committee—Prof. Richard Langhorne, Prof. Anna Gelpern, and Prof. Gabriella Kütting—for their helpful comments and thoughts, which undoubtedly strengthened my work. Prof. Kutting joined the committee at a critical time and continued to offer invaluable support and advice.

Prof. Yale H. Ferguson, the former Co-Director of DGA, supported me in diverse ways throughout my studies and deserves my gratitude. His encouragement, advice, gifts and timely intervention at a critical moment in my life will always be appreciated. His "Global Governance" course—anchored in "reality"—gave me the necessary grounding to study and appreciate the dynamics of globalization and transnationalism. Ms. Ann Martin, Associate Director and Ms. Desiree Gordon, Administrative Assistant in DGA were unfailingly helpful during my studies and deserve my appreciation.

I would also like to thank the numerous people—colleagues, friends, and well-wishers, far and near—who supported me in different ways. My thanks also go to Prof. D.E.K Amenumey, formerly of University of Cape Coast for recommending Illinois State University (ISU) to me and for writing to support my application to study there. I would also like to thank Dr. Agbenyega Adedze for his superb supervisory role when I served as his teaching assistant at ISU. Dr. Mark D. Wyman, my former graduate program advisor

at ISU deserves my gratitude. His interest in my advancement since I met him has not wavered one bit. I will always treasure his generous support, concern, and friendship.

Last but not least, I would like to thank my family for their support, love, and confidence in me. The real cost of my education is being away from them and from home. To them I dedicate this project. I am solely responsible for any shortfalls.

One point needs to be made and that is unless otherwise stated, newspaper articles cited in this study are online versions.

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CHAPTER 1

INTRODUCTION: UNDERSTANDING INTERNATIONAL POLITICAL ECONOMY

1. THE ISSUE AT STAKE

This dissertation argues that an alternate conceptual framework—the "marketplace framework"—more clearly explains the nature of International Political Economy (IPE) as a field of study and as a set of global conditions and activities.[1] It does so by analyzing the failure of the "tension framework" to effectively explain the process of evolution that led up to the 2008 global financial crisis and the political reactions to the crisis itself. The tension framework is the dominant paradigm that shaped interpretations and analyses of IPE since its emergence in the 1970s. It classifies "states" and "markets"—the main analytic units of the subfield—and investigates their relationship in antipodean terms.[2]

The dissertation is structured on three interrelated arguments. The first is that the tension framework lacks conceptual clarity and, therefore, befuddles comprehensive understanding of the nature of IPE. This argument rests on two connected reasons. The first reason is that the tension framework presumes states and markets are homogenous institutions in their respective domains. That is because it does not differentiate the *kinds*

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[1] A conceptual framework is a building block for vigorous theoretical analysis and interpretation. For a constructivist conception and interpretation of IPE as a discipline and as a set of global activities and conditions, see Kurt Burch, "Constituting IPE and Modernity," in *Constituting International Political Economy*, ed. Kurt Burch and Robert A. Denemark (Boulder and London: Lynne Rienner, 1997), 21.

[2] Robert Gilpin provides the dominant theoretical framework that has shaped IPE in theory and practice. He defines the subfield as "the reciprocal and dynamic interaction in international relations of the pursuit of wealth and the pursuit of power." See Robert Gilpin, *U.S. Power and the Multinational Corporation: The Political Economy and Foreign Direct Investment* (New York: Basic Books, 1975), 43. See also Robert Gilpin, "The Nature of International Political Economy," in *International Political Economy: State-Market Relations in a Changing Global Order*, ed. Goddard C. Roe, Patrick Cronin and Kishore C. Dash (Boulder, CO. Lynne Rienner Publishers, 2003): 9-24; Robert Gilpin, *The Political Economy of International Relations* (Princeton: Princeton University Press, 1987). On evolution of IPE as a subfield, see Stefano Guzzini, *Realism in International Relations and International Political Economy: The Continuing Story of a Death Foretold* (London and New York: Routledge, 1998).

of states and the *kinds of markets* that are in tensile relations from those that are not. States and markets differ and overlap in their particular realms and do not necessarily have same identities, interests, structures, and capabilities. The tension framework takes these particularities as a given and, as a result, contradicts and contravenes Max Weber's classic ideas of the state. "All states," Weber argues, "may be classified according to whether" the practical men of affairs are "separated" from the *means* of administration or whether they *own* the administrative means.[3] In other words, *ownership* of the means of administration is the single most important principle for distinguishing *one kind of state* from another. The tension framework disregards this principle. The second reason is that although the concept of *exchange* is a core characteristic of all markets, the invisible hand of the price adjusting mechanism—the glue of the market system—is a feature peculiar to financial market authorities. Financial markets mobilize savings, bear and share risks, diversify and hedge risks by transferring capital from surplus savings centers to deficit spending units based on the price adjusting mechanism.[4] Essentially, financial markets disseminate information and "run" the intermediary mechanism of exchange. Inherently, therefore, the mechanism of exchange or the price functioning system is not an attribute of all markets; it is a distinctive feature of financial markets. The tension framework does not make this conceptual precision; it rather embeds it just as it embeds all states.

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[3] In Weberian thought, physical force is "a means specific to the state," but it "is certainly not the normal or the only means of the state." I argue in this context that the fundamental *means* that makes monopoly on violence specific to the state is finance, which Weber alluded to as an essential part of the "emerging machine" in Liberal Prime Minister Gladstone's "ascent to power." For details, see Max Weber, "Politics as Vocation," available from http://www2.selu.edu/Academics/Faculty/jbell/weber.pdf (accessed March 9, 2010), 3, 7.

[4] Lawrence Summers discussed the functions of financial markets in a video interview, "View from Washington D.C.," hosted by Edwards Luce, Washington Bureau Chief of *Financial Times*. He did so in his capacity as Director of National Economic Council and Senior Advisor to President Obama. See Edward Luce, "Obama's Fiscal Stimulus will be Felt, Says Summers," *Financial Times*, March 1, 2010.

The second argument is that although the very notion of tension implies some sort of epistemological equality between state and market, the framework itself is market-dominated and was intended by many of its proponents (especially those in the policy world) to dismiss the state side of the equation and turn the "superiority" of the market into a given. In this sense, the tension phraseology only provides an attractive garb of difference for the assertion that rational markets are ultimately better than the state.

The third argument is that political reactions to the financial crisis invalidate the efficacy of the tension framework and create a theoretical gap between political reality and the self-regulating market orthodoxy. In other words, political interventions that prevented the crisis from tipping the global economy into a deep recession exposed the ineffectiveness of the tension framework's predictive and explanatory powers. In effect, the framework has failed to accomplish its stated claims and is, therefore, neither useful for explaining relations of states and markets nor the nature of IPE.

Given that the tension framework is no longer compelling means that there is the need for rethink of relations of states and markets. Thus, the dissertation argues that in order to understand the process of evolution that led to the crisis, the political reactions to the crisis itself, and the unconcealed nature of IPE, we need to re-frame and re-analyze the relationship of politics and finance in market framework terms at specific units of analysis. The marketplace framework focuses on relations of advanced liberal capitalist states and their financial markets (as the most fundamental units of IPE) instead of the broader "state-market relations." Its advantages are three-dimensional. First, it helps us to understand why the advanced liberal capitalist economy—finance and trade in commodities—is *designated* as a "self-regulating" realm independent of the state. The financial realm—defined in percentages of debt, equity, bonds, shares, promises, and securities—is *separated* from the physical economy because finance is a complex, evolving "legal fiction"[5] characteristic of advanced liberal capitalist system. That is to say the structures of finance in these states are different from other states. Second, the marketplace framework helps us to recognize that notwithstanding such "designations," governance in advanced liberal capitalist system unreasonably separates the structures of finance from liberal states because in Weberian thought, finance is the *means specific* to such states.[6] Such is evident in the fact that financial markets of these states expose their respective domestic political economy to external spheres while internalizing the 'outside' arena into their particular domestic realms. The third advantage is that the marketplace framework enables comprehensive critique of how state-market relations in general and politics and finance in particular have been presented by other observers.

In short, the dissertation contends that in order to grasp the true nature of IPE, we need to understand the relationship of advanced liberal capitalist states and their financial market structures because together they constitute the axis of the circumferential global

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[5] Finance is described as a "legal fiction" because its nature, processes, and multiplying effects in the political economy are "mysteries" that are not quite scriptable and, therefore, are abdicated by the liberal state to experts of banking and financial law. On finance as a legal fiction, see Gilbert K. Chesterton, quoted in William Z. Ripley, *Main Street and Wall Street* (Boston: Little Brown and Company, 1929), v-vi, 55-77. For analysis of the liberal state's gradual abdication of its authority on finance to private authorities, see Weber, "Politics as a Vocation," 7. For a broader perspective on this issue, see A. Claire Cutler, "Locating 'Authority' in the Global Political Economy," *International Studies Quarterly*, Vol. 43 (March, 1999): 59-81. With regard to finance being un-scriptable, see Gretchen Morgenson, "3,000 Pages of Financial Reform, But Still Not Enough," *New York Times*, May 29, 2010; Simon Johnson, "The Myth of Resolution Authority," New York Times, March 31, 2011.

[6] This argument—that finance is the central organizing principle of advanced liberal capitalist states—is as old as liberalism itself. As referenced in footnote 3 above, finance was a central element in Gladstone's ascent to power. For a comprehensive historical analysis of finance and politics, see Marion Mills Miller, ed., *Great Debates in American History: From the Debates in the British Parliament on the Colonial Stamp Act (1764-1765) to the Debates in Congress at the Close of the Taft Administration, 1912-1913- Volume 13, Finance*: *Part 1* (New York: Current Literature Publishing, 1913), 218.

political economy. Understanding these particular relations is critical to the total conception of IPE. For this reason, any IPE-related analysis and interpretations that do not recognize the centrality of finance to advanced liberal states and the broader market system is comparable to the lack of differentiation of varieties of capitalism or varieties of bankers.[7] That kind of analysis turns the study on its head.

2. COMPONENT ELEMENTS OF THE MARKETPLACE FRAMEWORK

As I noted earlier, the marketplace framework is constructed on three core concepts: *advanced liberal capitalist states* and *financial markets*, and *relations* that exist between the two. Defining the state is not an easy task. As Philip Cerny pointed out, the state is a "contested category both conceptually and in practice" and should, therefore, be seen as "*problematique*" at the beginning of debate and analysis. In other words, the concept of the "state" as a hierarchical, organizationally coherent and relatively efficient entity is an uneasy one.[8] Yale Ferguson and Richard Mansbach also argue that the state "is routinely defined to suit normative and/or empirical ends of scholars and practitioners" because it is "a concept about which few agree."[9] In my view, these arguments strongly reinforce the Weberian principle for classifying the state: the structure of the means of organization

[7] Varieties of capitalism include "crony capitalism," "ethnocapitalism," statist capitalism, merchant capitalism, industrial capitalism, corporatist capitalism, and financial capitalism. See Peter A. Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001). Bankers, on the other hand, include private, public, commercial, and investment bankers. They differ in their respective functions, and so are markets.

[8] In this context, Cerny observes: "some states can be organizationally 'strong' in the sense they can be rooted in widely accepted social identities and bonds, or that their institutions are effective and efficiently run, or that their 'writ' runs throughout the territory. They can also be powerful internationally. On the other hand, states can also be weak on both levels. All states have particular strengths and weaknesses along various dimensions, often cutting across the so-called 'inside/outside' distinction." For details, see Philip G. Cerny, "The Competition State Today," *Policy Studies* (2009), 6.

[9] Yale H. Ferguson and Richard Mansbach, "The Sociology of the State: The State as a Conceptual Variable," Paper presented at ISA's 50th Annual Convention, New York, NY, Feb. 15, 2009.

distinguishes one kind of state from another. That is to say the financial structure of an advanced capitalist state is underpins to the physical economy and the social structure.

Mindful of these definitional problems in general, and the tension framework's lack of conceptual clarity in particular, I define *advanced liberal capitalist state* as a state that constitutionally/statutorily guarantees and entrenches property/contractual rights and protection, pursues notions of equal political participation, practices credit organization as its object of excellence, and allows market institutions (defined in the broadest sense) to operate within pragmatic regulatory frameworks that harmonize private incentives with public welfare. I define *financial markets* as institutions and agencies, structures and processes as well as mechanisms that govern organization of credit across political space for short- and long-term investment. This definition consists of material resources, networks of economic and political institutions/agencies and sets of social practices associated with credit organization. Such is in tune with Benjamin Cohen's explanation of global finance as encompassing "all types of cross-border portfolio-type transactions—borrowing and lending, trading of currencies or other financial claims, and the provision of commercial banking or other financial services."[10] Financial markets select from competing ventures, monitor funded projects, record transactions and are, therefore, at

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[10] See Benjamin J. Cohen, "Phoenix Risen: The Resurrection of Global Finance," *World Politics*, Vol. 48, No. 2 (January 1996), 269. A financial system, in effect, is the combination of market institutions and regulatory instruments that govern credit organization. For details on finance, see Susan Strange, "Finance, Information and Power," *Review of International Studies*, Vol. 16, Issue 3 (July 1990), 259; Susan Strange, *States and Markets*: *An Introduction to International Political Economy* (New York: Basil Blackwell, 1988), 88; Susan Strange, "Finance in Politics: An Epilogue to *Mad Money*," in *Political Space: Frontiers of Change and Governance in a Globalizing World*, ed. Yale H. Ferguson and R. J. Barry Jones (Albany: State University of New York Press, 2002): 189-209; Philip G. Cerny, "The Political Economy of International Finance," in *Finance and World Politics: Markets, Regimes and States in the Post-hegemonic Era*, ed. Philip G. Cerny (Aldershot: Edward Elgar, 1993); Randall D. Germain, *The International Organization Credit: States and Global Finance in the World-Economy* (Cambridge: Cambridge University Press, 1997), 17-18.

the heart of production, processing, distribution, consumption and utilization of market-based information. They are different from other forms of markets and must be treated as such. As Joseph Stiglitz rightly argues, financial markets can be conceptualized as the "brain" of the entire economic system—the "central locus of decisionmaking."[11]

According to A. S. F. Nadel, the term "relation" has "double meaning;" it is used to denote "both the interaction of units and the positions they occupy vis-à-vis each other."[12] "Interactions," as Kenneth Waltz explains, "take place at the level of the units."[13] Thus, in the context of this dissertation, *relation* means interaction between political institutions and agencies (executive, legislative, and judicial arms) of advanced liberal capitalist states and their systemic financial market authorities (central banks, securities and futures exchanges, and private credit regulating institutions responsible for financial and monetary policies) and the position they occupy vis-à-vis one another in domestic as well as in the international political economy .

This brings us to the *marketplace framework*, which I define as a coordinated, interactive political space in which political authorities of advanced liberal capitalist states provide security and stability, construct asset representation systems, create and maintain conditions for property/contractual rights, generate investors' confidence and depositors' trust, and guarantee (overtly and covertly) to manage systemic financial risks in *exchange* for financial market institutions to *responsibly* invent value for factors of production, integrate innovative information, create competitive financial instruments,

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[11] Joseph E. Stiglitz, "The Role of the State in Financial Markets," *Proceedings of the World Bank Annual Conference on Development Economics* (1993), 23. See also Murray E. Polakoff et el., *Financial Institutions and Markets* (Boston and New York: Houghton Mifflin, 1970), 5-6.

[12] Kenneth N. Waltz, *Theory of International Politics* (New York: Random House, 1979), 80.

[13] Waltz, *Theory of International Politics*, 80.

and efficiently allocate fungible assets that are *necessary* for organizing structures of the advanced liberal capitalist states and the international political economy. In other words, the marketplace framework is an exchange/reciprocal relation between politics and finance—a fusion of social and political structures that provides dynamic equilibrium for liberal capitalist states and the global political economy. The concept of *exchange* that comes to mind when rational calculating market participants trade equity for capital investment or use collaterals to access credit, is the main analytic component of the marketplace framework. This framework provides static equilibrium through political socialization by way of symbiotic constitutional compact and market-based exchange system. It enables comprehensive understanding of the predisposition of governments of advanced liberal capitalist states and their financial market institutions working together in pursuit of one another's domestic and international objectives and interests.[14]

In short, the marketplace framework is an organic, non-tensile process. It is an embedded confidence and trust exchange system that is political in nature. It is political because as Susan Strange accurately noted, the phenomenon of borrowing and lending—i.e., "getting money today in exchange for money tomorrow—is economic. But how such transactions are managed is political."[15] It is organic because of its rhythmic coordination process and evolutionary flexibility. Coordination makes interaction of market-based practices and political traffic in liberal capitalist policy making dynamic. Such is achieved and maintained through what I call pragmatic regulatory coordination.

[14] See a similar view in J. Andrew Spindler, *The Politics of International Credit: Private Finance and Foreign Policy in Germany and Japan* (Washington, D.C: The Brookings Institution, 1984), 6-7.

[15] Susan Strange, "The New World of Debt," *New Left Review* I/230 (July-August, 1998), 92.

3. PRAGMATIC REGULATORY COORDINATION

Pragmatic regulatory coordination is the embedded process in which systemic financial market authorities of advanced capitalist states (despite officials' ideological cleavages) are privileged and insulated from politicking to design, engineer, and execute financial and monetary policies that are conceived, perceived, interpreted, and consumed as if such policy contents and processes are devoid of politics.[16] It is a politically-designed interactive process that combines private financial interests with public interests in changing circumstances. Pragmatic regulatory coordination consists of broad statutory instruments and extraordinary political processes that are concurrently principled, formal and informal, specific and vague, direct and indirect, tacitly flexible and firm, and subtly sinuous and expedient.[17] Pragmatism is imperative not only because advanced financial instruments, products, and processes are never entirely scriptable, but because finance holds unique relationships to people and polities as it is central to their social fabric. In this sense, it is absolutely necessary to *hedge* efficiency of systemic private economic interests against social returns. That is because competitive financial markets do not always produce socially desirable outcomes[18]—outcomes that very often are disharmonic

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[16] Central banks are key institutions that are "insulated" from politics. Others in the U.S. include Securities Investor Protection Corporation (SIPC), which was established by an Act of Congress (in 1970) as a "nonprofit corporation," but has tremendous influence on regulatory coordination of securities markets.

[17] See for instance, Lisa Lee "Resolution Authority—Too Vague to Succeed," *The Wall Street Journal*, September 2, 2010. For details on liberal state authorities' preference for ad hoc, spontaneous measures and processes of handling finance, see Johnson, "The Myth of Resolution Authority."

[18] Many observers are at a loss as to why the ongoing financial reforms—driven largely by public resentments to the crisis—rather fuels risk taking in financial markets. On this issue, see Telis Demos and Jamie Chisholm, "Financial Reform Agreement Fuels Risk Taking," *Financial Times*, June 25, 2010. A pragmatic approach to understanding relationship of finance and advanced liberal politics would help them come to terms with why it is so. On why financial markets often produce socially undesirable outcomes, see Joseph Stiglitz, "Regulation and Failure," in *New Perspectives on Regulation*, D. Moss and J. Cisternino, ed. (Cambridge, MA: Tobin Project, 2009), 12.

to the principles of democratic capitalism. In essence, pragmatic regulatory coordination guarantees democratic participation, financial innovation, political and systemic stability.

Regulatory coordination takes the form of financial policy interactions among the three arms of the liberal democratic state (with specialized agencies) and systemically important financial institutions. Specialized political institutions include trade-related quasi-judicial agencies such as securities and exchange authorities. Financial market authorities include regulating, regulated, and self-regulating institutions such as stock exchanges and credit rating agencies. Between regulating agencies, regulated entities, and self-regulating bodies are central banks, which are structurally public and private, as they are economic and political in function. The importance of financial market authorities stems from regulatory coordination of intermediary mechanism of exchange.

In sum, pragmatic regulatory coordination is not conflictual; it rather enhances the health and security of the market system. The lack of it leads to frequent financial panics, market volatility, and economic crisis across political space. Reliance on it makes the marketplace framework the postulated and uniting principle of the advanced capitalist system and the global economy. Within pragmatic regulatory coordination that tension management as well as the material *means* of administration is organized. Finance sustains as well as unifies the marketplace framework. Financial markets are at the heart of liberal capitalist states because credit organization is their peculiar excellence.

4. LEVELS OF ANALYSIS

To make the marketplace framework coherent, the dissertation focuses on U.S. and U.K.—the two advanced liberal capitalist states—and their financial markets. Both are mature market economies in a state of equilibrium prior to the global financial crisis.

Both are organizationally strong, with their institutional structures run effectively and efficiently (Cerny). And their form and degree of governance embody organization, consensus, legitimacy, and pragmatic regulatory coordination. Comparatively, both states allow greater degree of *freedom* for their private economic institutions, with clear-cut separation between management and ownership—the very basis of modern corporate capitalism.[19] Their credit markets (with developed banking sectors) are led by financial institutions rather than by the state and much of their capital raising activities revolve around equity markets, compared to other major economies (Cerny). In a Weberian sense, political authorities of these states are 'separated' from the administrative means.

In particular, financial markets of these states have considerably longer history of open credit organization across sovereign political realms. Both have the most developed world financial centers in modern times. Their credit markets are "deep," "liquid," more "globalizing" and more transnationalizing than other states. Not only have they reputable domestic financial systems with global credit rating agencies (owned or headquartered) in their principal credit centers; they have "steady access to domestic and international investors" and have the "capacity to issue debt in their own currencies."[20] Certainly, their globalizing positions are entrenched and consolidated in international finance, with their world reserve currencies reinforcing their authority and influence in overseas credit

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[19] Joseph E. Stiglitz, "Credit Markets and the Control of Capital," *Journal of Money, Credit, and Banking*, Vol. 17, No. 2 (May 1995): 133-152.

[20] See Anna Gelpern, "Domestic Bonds, Credit Derivatives, and the Next Transformation of Sovereign Debt," *Chicago-Kent Law Review*, Vol. 83, No. 1 (2008), 147-148; Anna Gelpern and Mitu Gulati, "Public Symbol in Private Contract: A Case Study," *Washington University Law Review*, Vol. 84 (2006), 1633; Philip G. Cerny, *Rethinking World Politics: A Theory of Transnational Neopluralism* (Oxford: Oxford University Press, 2010), 252. See also Martin Wolf, "The Post-Thatcher Era Begins," *Financial Times*, December 3, 2009; Paul Langley, *World Financial Orders: An Historical International Political Economy* (London and New York: Routledge, 2002).

markets. Indeed, as Gordon Clark observes, "London and New York represent in space the dominant global financial system of the late twentieth and early twenty-first centuries. Their relationship is at once competitive, and reciprocal, being joined together by a common legal and economic heritage."[21] In fact, globalization is often seen as an Anglo-American whirlpool that is complementarily coordinated between the two states. This is because both states have practiced what Cerny calls "patterns of open capitalism" with "monetary and financial hegemony" more than any other state in our modern era.[22]

In addition, U.S. and U.K. have been more successful at fusing political processes and market economies with a sense of shareholder ownership and control.[23] The fusion was implemented over the centuries through national debts in the form of buying and selling of government bonds through which "the interests of the governed and the government became one."[24] Such interests are protected by the rule of law, which is fashioned on market mechanisms of free exchange of goods, services, and ideas without visible government intervention. The free exchange system allows fungible relationships

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[21] Gordon L. Clark, "London in the European Financial Services Industry: Locational Advantage and Product Complementarities," *Journal of Economic Geography*, Vol. 2 (2002), 434. See also Saskia Sassen, *The Global City: New York, London, and Tokyo*, 2nd ed. (Princeton: Princeton University Press, 2001), 65-126. See also Cerny, "The Competition State Today," 6.

[22] See Cerny, "The Competition State Today," 8; Cerny, *Rethinking World Politics*, 252. See also James Davidson Hunter and Joshua Yates, "In the Vanguard of Globalization: The World of American Globalizers," in *Many Globalizations: Cultural Diversity in the Contemporary World*, ed. Peter L. Berger and Samuel P. Huntington (Oxford and New York: Oxford University Press, 2003): 323-358.

[23] See Gordon S. Wood, "Inventing American Capitalism," *The New York Review of Books*, June 9, 1994; Gordon S. Wood, "Early American Get-Up-and-Go," *New York Review of Books*, June 29, 2000, 53; Gordon L. Clark, "London in the European Financial Services Industry," 434. See also Alan Greenspan, *The Age of Turbulence: Adventures in A New World* (New York: Penguin, 2007), 139.

[24] Robert E. Wright, *One Nation under Debt: Hamilton, Jefferson, and the History of What We Owe* (New York: McGraw-Hill, 2007), 1. See also John Steele Gordon, *Hamilton's Blessing: The Extraordinary Life and Times of Our National Debt* (New York: Walker Publishing Company, 1997); John Steele Gordon, *The Great Game: The Emergence of Wall Street as a World Power 1653-2000* (New York: Scribner, 1999).

across political space. As Martin Wolf noted, "the great virtue of liberal democracies and market economies is their ability to reform and adapt."[25] He is absolutely right.

These features—deep, mature, globalized liquidity markets, freedom of economic institutions, separation of *administrative means* from political officials, steady access to international savings—make both states fundamental to the marketplace framework.

The focus on these states and their financial markets means the levels of analysis are domestic as they are international. Put in other words, the levels are "intermestic."[26] They are so described because operations of these markets and their rating agencies cut across multiple, overlapping political realms. In fact, it is the power and dynamism of international finance cutting across multiple political spheres that created what Fernand Braudel refers to as the single "world-economy" or the "world system," as Immnanuel Wallerstein puts it.[27] To emphasize an earlier point, financial structures of advanced liberal capitalist states play paradoxical roles in the international political economy in the sense that they open their respective domestic activities to external political processes and events while internalizing foreign affairs and process into the domestic arena. In this

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[25] Martin Wolf, "Victory in the Cold War was a Start as well as an Ending," *Financial Times*, November 10, 2009.

[26] Bayless Manning coined the term "intermestic" as a framework to analyze how Congress and Executive arms of U.S. government could deal with interactive issues and processes that are simultaneously domestic and foreign. In the same sense, Cerny argues: "the foreign or external is no longer external or 'outside.' It is internalized," and vice versa. See Bayless Manning, "The Congress, the Executive and Intermestic Affairs: Three Proposals," *Foreign Affairs*, Vol. 55, Issue 3 (April, 1977): 306-324; Cerny, "The Competition State Today," 2.

[27] See Germain, *The International Organization of Credit*, 15-16; Immanuel Wallerstein, *The Modern World-System: Capitalist Agriculture and the Origins of the European World-Economy in the Sixteenth Century* (New York: Academic Press, 1974). Cerny's analyses reinforce this claim when he observes that "developments in international and transnational finance – given that finance within countries is increasingly inseparable from finance between and cutting across countries – interact with changing relationships and structures of power in the international arena." See Cerny, "The Political Economy of International Finance," 5.

context, finance is truly interstitial because it situates as well as operates across sovereign political realms.[28]

In sum, the choice of the U.S. and U.K settles the levels of analysis problem in that both states are politically internationalists and their credit markets are globalizing, even in the midst of the greatest financial crisis in history. Together, they constitute the axis of IPE. Thus, to say that we "live in financial times" means we live in a globalizing world economy that is structured on financial levers of the two hyper-liberal states.

5. METHODOLOGY

The methodology employed is analytic, qualitative, historical, and interdisciplinary in approach. By analytic, I mean examining the components of states and markets at specific units for better understanding of their relations. By interdisciplinary, I mean what Robert Gilpin refers to as "eclectic mixture of analytic methods and theoretical perspectives" and Geoffrey Underhill calls "genealogy of interdisciplinary."[29] As Gilpin noted, interdisciplinary method allows "a general comprehension of the process of social change, including the ways in which the social, economic, and political aspects of society interact."[30] In fact, such is truly in line with Randall Germain's declaration that IPE "is a field with few boundaries and more than its share of questionable concepts and

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[28] See Cerny, "The Competition State Today," 1. John Zysman holds a similar view by way of summarizing Peter Kenen and Laura Tyson when he notes that "the structure of domestic [financial] institutions determines how the external disturbance is translated into a domestic disturbance in particular national economy." See John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change*, 4th reprint (Ithaca and London: Cornell University Press, 1994), 56. In fact, it is financial capabilities of these two liberal states that allow them to act extraterritorially.

[29] Gilpin, *The Political Economy of International Relations*, 9. On genealogy of interdisciplinary, see Underhill, "State, Market, and Global Political Economy: Genealogy of an (inter-?) discipline"; Burch, "Constituting IPE and Modernity." The eclectic theoretical and methodological perspectives employed in this work include (neo)liberal, (neo)realist, Marxist, and constructivists' worldviews.

[30] Gilpin, "The Nature of Political Economy," 10.

definitions."[31] The dissertation draws elements from other realms of knowledge such as economic and financial history, sociology, public policy, and public and private law because the issues and themes examined cross intellectual traditions of the disciplines.

The wonder of analytic method cannot be overstressed. It helps to disaggregate reality to examine its component parts, observe their relationships at micro-micro or micro-macro levels, and then re-totalize the parts to see the whole again. Waltz argues that analytic method works well where "relations among several factors can be resolved into relations between pairs of variables 'while other things are held equal.'"[32] Holding other things 'equal' in order to examine sectional parts of the whole is the hallmark of the social sciences in general. Stated differently, the main benefit of analytic method is that it enables one to reduce entities into their distinct parts, examine their subtle connections, study them in relatively simplistic form and then aggregate them to remake the whole again. Thus, analytic method is used in our context to reduce the concepts of the "state" and the "market" into their relative and most significant units in order to analyze their relations/interactions in theoretical, historical, and contemporary settings. As Gilpin rightly observes, analytic method helps to break down social reality, which like physical reality, into manageable parts for comprehensive study, understanding, and appreciation.

6. STRUCTURE OF THE DISSERTATION

Chapter 2 critiques in greater detail the hypotheses and explanatory claims of the tension framework vis-à-vis the market framework. Chapter 3 focuses on the ideological origin

[31] Germain, *The Organization of International Credit*, xi; Underhill, "State, Market, and Global Political Economy: Genealogy of an (inter-?) discipline," 802.

[32] Waltz, *Theory of International Politics*, 39.

and development as well as the regurgitation and appropriation of the notion of "tension" from territorial expansionism and the march of empire-states into state-market analysis. Chapter 4 investigates the marketplace framework conceptually by focusing on the nature and relational power of finance and how its structures are politically coordinated and hedged to produce desirable outcomes across space. Emphasis is placed on pragmatic regulatory coordination and symbiotic relations of finance and liberal capitalist states.

Chapter 5 surveys the marketplace framework in its historical dimension. It focuses on the paradox of finance in the two advanced liberal states and 'distills' out marketplace relations from de facto and de jure policy choices, institutional developments processes, prevailing social and political conditions, and non-territorial regulatory coordinating practices that shaped the growth and expansion of financial capitalism. It argues that financial governance in both states is a mixture of private and public affairs. The chapter explores how politics and legal structures *designate* trade and finance as "independent" realms, with "governance" lacking specificity and fixed principles.

Chapter 7 investigates contemporary dimension of the marketplace framework and examines regulatory and de-regulatory practices that characterized Bretton Woods fixed exchange rate regime and floating exchange rate system. It examines finance related policy choices of the two advanced capitalist states and concludes that such were either designed to globalize their financial markets or manage potentially destabilizing credit crisis. The marketplace framework in this sense reflects Cerny's argument that regulation or deregulation is, in effect, re-regulation. Chapter 6 reviews the marketplace framework and outlines its potential usefulness vis-à-vis the exposure the global financial crisis has given the tension framework and the damage done to its intellectual foundation.

7. CONCLUSION

The 2008 global credit crisis was the quake that shattered the façade of the tension framework and exposed the umbilical cord between advanced liberal capitalist states and financial market structures. Financial market institutions that supposedly railed against states restricting their sustaining profit and political actors and institutions that decried the influence of financial forces on their commitment to public goods eventually found themselves huddled together to find common solutions to their cognate problems. Many were surprised by the pragmatic intervention when, in fact, they had anticipated epic struggles. Many expected the crisis would push states further away from markets forces and humble them into a reconsideration of their practices. But to their befuddlement advanced liberal capitalist states did not react in contrary ways, when credit markets went into violent motion, which strongly support the marketplace framework that politics and finance are not different in function and purpose. IPE students are forced to question the orthodoxy of the tension framework vis-à-vis real world events dissected in newspapers and television coverage. In effect, the framework that was disguised to the shrewd and the prudish was now exposed to toddlers and the suckling. Given the damage done to it, I argue that the marketplace framework offers the best alternative for re-conceptualizing of the "multiple stories" underway in contemporary globalization and IPE.[33]

Fundamentally, the marketplace framework is rooted in regulatory pragmatism instead of tension dogmatism. It reinforces the late Senator Nelson Aldrich's century old remark that "political economy has no laws applicable to every community and under all

[33] Anna Leander, "Why We Need Multiple Stories about the Global Political Economy," *Review of International Political Economy*, Vol. 16, No. 2 (May 2009), 327. See also Cerny, *Rethinking World Politics*, especially chapter 2.

circumstances."[34] Political economy is what each state makes of its circumstances. He was right, for pragmatic regulatory coordination is what advanced liberal capitalist states make of their political economies and the global political economy, by extension. This, in fact, sheds light on Foucault's governmental rationality in its global context. Pragmatic regulatory coordination of finance-based market-rationality created a façade of "tension" embedded in common sense and rationalized as global consciousness.

[34] Senator Aldrich made this statement in his capacity as chairman of U.S. Senate Finance Committee (1898-1911) and the National Monetary Commission—the study group whose report became the basis of the Federal Reserve Act of 1913 and the Federal Reserve System. For details, see *An Address by Senator Nelson W. Aldrich before the Economic Club of New York on the Work of the National Monetary Commission* (Washington, D.C.: Government Printing Office, 1910), 25.

CHAPTER 2

OVERVIEW OF TENSION AND MARKETPLACE FRAMEWORKS

1. INTRODUCTION

The strategy to explain in greater detail the significance and component elements of the marketplace framework is to reexamine the suppositions and explanatory claims of the tension framework. This approach is consistent with Waltz's argument that when a theory or an analytical framework fails to accomplish its stated claims, it should not be discarded; instead, its hypotheses should be reconsidered, its assumptions restated and repaired, and its scope of explanatory claims narrowed.[1] That exactly is the goal of this chapter. But to do that requires redefinitions and reclassifications of identities and interests of the analytic units being considered. As Alexander Wendt argues, "identities are the basis of interests."[2] Therefore, understanding actors' identities is a necessary condition for thorough analysis of their interests and actions/inaction.

2. HYPOTHESES OF THE TENSION FRAMEWORK

As I noted earlier, the tension framework epitomizes the inherent relationship between the pursuit of private economic interests and the logic of collective political action. It constructs the relationship of states and markets into two contrasting governing realms, with the state representing territorially structured political command and the market denoting non-territorially bound economic authority. The relationship between these

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[1] Waltz, *Theory of International Politics*, 13.

[2] Alexander Wendt, "Anarchy is What States Make of It: The Social Construction of Power Politics," *International Organization*, Vol. 46, No. 2 (Spring 1992), 398.

realms is framed broadly as mutually interactive and tension-driven, a relationship of two independent, seemingly detached institutions motivated for power to organize society.

The fundamental assumption of this relationship is that states and markets are in an uncompromising "struggle for relative efficiency,"[3] which, in effect, means they are in a power-fueled competition to organize and allocate scarce resources. The struggle is premised on the notion that states and markets have independent existences and interact with one another in diametrically opposed logics.[4] The state is organized around political ideals such as equality and justice (including the sharing/or distribution of power among groups within the state, guaranteeing "baseline conditions for acceptable human life," providing civil rights such as individual liberties and due process) while the market is structured "around material relations of profit, exchange, and economic efficiency."[5] Understood from these perspectives, the logic of the state—rooted in political power—pulls the relationship in one direction while the logic of the market—set in profit motive and rational exchange behavior— pulls it in the other direction. As Geoffrey Underhill pointed out, within these entrenched logics, political rationality may be invoked to invalidate market authority or market forces may subdue efforts at political definition of

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[3] Halford Mackinder used the phrase "struggle for relative efficiency" in reference to the tense, world-wide economic conflict that triggered what he calls the "post-Columbian age" of territorial expansion (1480-1900). I used the phrase in the same sense. See Halford J. Mackinder, "The Geographical Pivot of History," *The Geographical Journal*, Vol. 23, No. 4 (April 1904), 422.

[4] Gilpin, *The Political Economy of International Relations*, 10, fn. 1. See also Geoffrey R. D. Underhill, "Theorizing Governance in a Global Financial System," in *The Political Economy of Financial Market Regulation: The Dynamics of Inclusion and Exclusion*, ed. Peter Mooslechner, Helene Schuberth, and Beat Weber (Cheltenham: Edward Elgar, 2006), 19.

[5] Cerny, "The Competition State Today," 6. See also Weber, "Politics as a Vocation," 1. For the quote starting with "baseline," see Bertrand Russell, *Political Ideals* (New York: The Century Co, 1917), 4.

outcome.[6] But either way, the two governing spheres exist in complete opposition to each other. Understood in this sense, the relationship is truly an uncompromising one.

Notwithstanding their antagonistic existence, however, neither the state nor the market is conceived of as an entity unto itself. The conceptual boundaries between them are never "entirely congruent;"[7] they are "problematic" and, in essence, "an *unfinished political* project with structural contradictions."[8] Such contradictions, as Susan Strange observes, mean that "the relation of market authority to political authority has never been stable for long, and at different times and in different places the pendulum has swung away from one end toward the other and back again, often in ways unforeseen by contemporaries."[9] Not only is the oscillation imbalanced by its inherently combative nature, the pendulum is increasingly jostled by a myriad of endogenous variables. This inability to maintain long-term static equilibrium is broadly analyzed and interpreted as the purest illustration of the tensile relation between the two governing units.

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[6] Geoffrey R.D. Underhill, *States, Markets and Governance: Private Interests, the Public Good and the Democratic Process* (Amsterdam: Vossiuspers UvA, 2001), 14. Versions of this analysis can be found in Geoffrey R. D. Underhill, "States, Markets and Governance for Emerging Economies: Private Interests, Public Good and the Legitimacy of the Development Process," *International Affairs*, Vol. 79, Issue 4 (July 2003), 20; Underhill, "Theorizing Governance in a Global Financial System," 13, 19.

[7] Yale H. Ferguson and Richard W. Mansbach, *Remapping Global Politics: History's Revenge and Future Shock* (Cambridge: Cambridge University Press, 2004), 187.

[8] Philip G. Cerny, "Neoliberalisation and Place: Deconstructing and Reconstructing Borders," in *The Disoriented State: Shifts in Governmentality, Territoriality and Governance*, eds., Bas Arts, Arnoud Lagendij and Henk van Houtum, (n.p.: Springer, 2009), 17. Michel Foucault expressed a similar view when he notes that "The state is at once that which exists, but which does not yet exist enough" is a "constructed" reality. See Michel Foucault, *The Birth of Biopolitics: Lectures at the Collegé de France, 1978-1979*, ed. Michel Senellart, trans. Graham Burchel (New York: Palgrave Macmillan, 2008), 4.

[9] Susan Strange, *Retreat of the State: The Diffusion of Power in the World Economy* (Cambridge: Cambridge University Press, 1996), 45. Similar ideas are expressed in Martin Sorrell's "The Pendulum Will Swing Back," *Financial Times*, April 8, 2009 and David Brooks' "The Commercial Republic," *New York Times*, March 16, 2009.

The lack of a durable balance is attributed to the natural inclination of markets to grow beyond political space, but state bureaucrats have a tendency to restrain them from expanding into their defined jurisdictions. These contrasting predispositions presume a predictable occurrence of an interminable politicization of economic issues vis-à-vis a continual market reaction to political rhythms, processes, and decisions. The proclivity of markets to operate across political space as against the propensity of state authorities to "control" them is what I mean by *tension framework*. Orthodox IPE scholarship frames this relationship broadly as the epic struggle between transnational markets (broadly construed) and national governments. Gilpin's analysis of this relationship succinctly captures its tensile nature:

> Too often policy issues are analyzed as if the realms of economics and politics can be isolated from one another. Events in the final years of the twentieth century are forcing students of international relations to focus their attention on the *inevitable tensions* and *continuing interactions* between economics and politics…. The *tension* between these two fundamentally different ways of ordering human relationships has profoundly shaped the course of modern history and constitutes the *crucial problem* in the study of political economy.[10]

Gilpin is one of many scholars to have emphasized *inevitable tension* as constituting the fundamental puzzle in the study of political economy.[11] Others have written about it in equally forceful ways. Cerny conceptualizes it as a "tug-of-war

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[10] Gilpin explains the source of this inevitable conflict as follows: "In a purely political world in which markets did not exist, the state would allocate available resources on the basis of its social and political objectives; such state allocative decisions would take the form of state's budget. In a purely 'market' world in which state intervention did not occur, the market would allocate and operate on the basis of relative prices for goods and services; decisions would take the form of individual pursuit of self-interest .... Although the state as the embodiment of politics and the market as the embodiment of economics are distinctive features of the modern world, they obviously cannot be totally separated." See Gilpin, *The Political Economy of International Relations*, 3, 9-11; Gilpin, "The Nature of International Political Economy," 11.

[11] As constructivists argue, the assumption of inevitable tension is mainstream IPE's "monumental blind spot." See Mark Rupert and S. Scott Solomon in *Globalization and International Political Economy: The Politics of Alternative Futures* (Oxford: Rowan & Littlefield, 2006), 11-12.

between national governments and transnationalized markets."[12] Jeffry Frieden and David Lake describe it as "the interplay of economics and politics in the world arena."[13] Geoffrey Underhill alludes to it, jadedly, as "state-market dichotomy" or "interdependent antagonism."[14] Underhill writes: "the core question in political economy today remains as it always has been: the relationship between the market (and the private interests and prerogatives it includes), and political authority at various levels of governance (and the notions of the public interest which we like to presume are inherent in politics."[15]

Along with these scholarly analyses and interpretations are works whose titles explicitly reflect tension between the two governing entities. Among them are Peter Evans, Dietrich Rueschemeyer, and Evelyne Huber Stephens' edited *States versus Markets in the World-System*, Susan Strange's *States and Markets* and *The Retreat of the State*, Eric Schutz's *Markets and Power*, Herman Schwartz's *States versus Markets*, George Shambaugh's *States, Firms, and Power*, Adam Przeworski's *States and Markets: A Primer in Political Economy*, John Stopford and Susan Strange's *Rival States, Rival Firms* as well as Robert Boyer and Daniel Drache's edited *States against Markets: The Limits of Globalization*. Each one of these works emphasizes the epic struggle that has

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[12] Cerny, "The Political Economy of International Finance," 10.

[13] Jeffry A. Frieden and David Lake, eds., *International Political Economy: Perspectives on Global Power and Wealth*, 4th ed. (Belmont, CA: Wadsworth/Thomson, 2000), 1. For a critique of orthodox IPE, see Kurt Burch, "Constituting IPE and Modernity," 21-40.

[14] See Underhill, *States, Markets and Governance*, 14-15; Underhill, "States, Markets and Governance for Emerging Economies, 764;" Underhill, "State, Market, and Global Political Economy," 820.

[15] Underhill, *States, Markets and Governance*, 7; Underhill, "State, Market, and Global Political Economy: Genealogy of an (Inter-?) discipline," 814; Underhill, "Theorizing Governance in a Global Financial System."

defined and shaped IPE—the struggle in our globalizing world economy in which markets (broadly interpreted) were construed to be winning.

This perception is well expressed in Benjamin Cohen's review article, "Phoenix Risen: The Resurrection of Global Finance," in which he observes:

> At a minimum, financial globalization has put governments distinctly on the defense, eroding much of the authority of contemporary sovereign state. At a maximum, it may have irreversibly altered the meaning of geography in the world economy today.[16]

The altered meaning of geography in our globalizing world economy embodies the tension framework's essential hypotheses: autonomous existences of states and markets and inevitable collisions between the logic of political power and the logic of economic efficiency. With states and markets as dual rudders, the direction of the global political economy is, therefore, the result of their interactive processes rather than a pure representation of the preferred direction of either. In effect, markets manipulate the pulse of politics while states manage their political responsibilities in tandem with the *material means* that market institutions organize across juridical states. In this sense, the political economy of international relations, as Gilpin defines/explains it, is the mutual and pulsating interaction for pursuit of wealth and the search for power. That means the search for power and the pursuit wealth in interstate relations are antipodean in nature.

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[16] Cohen, "Phoenix Risen: The Resurrection of Global Finance," 270. For similar contentions about the erosion of sovereign state authority, see Timothy J. Sinclair, "Between State and Market: Hegemony and Institutions of Collective Action under Conditions of International Capital Mobility," *Policy Studies*, Vol. 27, No. 4 (December 1994); Benjamin J. Cohen, *The Geography of Money* (Ithaca and London: Cornell University Press, 1998) and John B. Goodman and Louis W. Pauly, "The Obsolescence of Capital Control? Economic Management in an Age of Global Markets," *World Politics*, Vol. 46, No. 1 (October 1993): 50-82. For a recent theoretical exposition on the subject, see Cerny, *Rethinking World Politics*. One may contrast these (neo)liberal views with Stephen D. Krasner's realist position as argued in his *Sovereignty: Organized Hypocrisy* (Princeton: Princeton University Press, 1999) and *Power, the State, and Sovereignty: Essays in International Relations* (London and New York: Routledge, 2009).

Although the contemporary theoretical origin of the tension framework goes further back than the 1970s, it was not until the early 1980s that the framework actually became the foundation of the competitively redesigned, self-regulating market system. The fundamental elements of this system are structured on the firm notion that the profit motive of rational market players—driven by the price adjusting mechanism—spurs the economy to Pareto efficient outcomes. As Joseph Stiglitz explains it, the intermediary mechanism of exchange not only clears markets of surpluses and shortages, it is simply the best standard that measures the "marginal benefit of a good to a buyer and the marginal cost to the seller."[17] Stated in other words, the ruling prices in competitive markets—based on "counterparty surveillance"—perfectly reflect the best judgment on product conditions. That is because the price reflects all available information necessary for rational choices, preferences, and decision-making in the exchange environment. In short, the price rules in perfect, competitive markets.

Reinforcing this notion is the grand theory that markets are not only rational and efficient, but that they always return towards general equilibrium, in other words, markets are not only self-stabilizing, they are self-regulating and self-correcting. Therefore, the main role of the state is to build institutional structures for the smooth functioning of markets, which means that state intervention in the workings of markets must be kept at the barest minimum. This rationalization is fashioned on the claim that political actors generally lack adequate information to comprehend market processes. In essence, the

[17] Stiglitz, "The Role of the State in Financial Markets," 23-24. Joseph E. Stiglitz, *Globalization and Its Discontents* (New York and London: W. W. Norton & Company, 2003), 73. For further analysis of the price mechanism, see Grahame Thompson, Jennifer Frances, Rosalind Levačić, Jeremy Mitchell, eds., *Markets, Hierarchies and Networks: The Coordination of Social Life* (London: Sage Publications, 1991).

self-correcting market system, as Stephen Roach of Morgan Stanley observes, is a created "mindset that policy is impotent to solve economic problems and that the system can do it on its own terms."[18] This is the frame of thought within which mainstream IPE evolved.

Advocates promoted this theoretical framework as the irreversible functioning structure of the global political economy. And they theorized broadly about states as having lost the regulatory powers—governance by command and control—they once exercised over markets. Gregory Millman's assertion in 1995 that politicians had no doubt where the power lied, illustrates the alleged monumental shift of state authority to market authority.[19] Richard McKenzie and Dwight Lee made a similar claim four years earlier by declaring that governments at every level had lost "the vestiges of unchecked economic sovereignty."[20]

So forceful and persuasive were these claims that the tension paradigm became the mandatory frame of thought through which transnational, transformative politics of economic liberalization, privatization of national assets and competitive deregulation of

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[18] Quoted in Michael Hirsch, *Capital Offense: How Washington's Wise Men Turned America's Future to Wall Street* (Hoboken, NJ: Wiley & Sons, 2010), 48. On the role of states in neoliberalism and rationalization of politicians' lack of knowledge of market functioning, see David Harvey, *A Brief History of Neoliberalism* (Oxford: Oxford University Press, 2005), 2.

[19] Gregory J. Millman, *The Vandals' Crown: How Rebel Currency Traders Overthrew the World's Central Banks* (New York: Free Press, 1995), 24.

[20] Richard B. McKenzie and Dwight R. Lee, *Quicksilver Capital: How the Rapid Movement of Wealth Has Changed the World* (New York: Free Press, 1991), xi. On broader claims of diffusion of states' regulatory powers by markets and institutions, see Strange, *The Retreat of the State*, 43; Roger G. Noll, ed., *Regulatory Policy and the Social Sciences* (Berkeley, CA: University of California Press, 1985), vii. As Ferguson and Mansbach noted, the era of neoliberalism witnessed "more states, regardless of history and culture … privatizing government functions, deregulating major sectors of their economies … willingly and unwillingly tailoring their policies to the demands" of markets. See Ferguson and Mansbach, *Remapping Global Politics*, 181.

market inhibiting structures were designed, implemented, and enforced.[21] The collapse of the Soviet Union into its constituent elements and the election of hitherto Marxist-Socialist-turned neoliberal reformist politicians on the global political scene reinforced the dominance of this paradigm. Its predictive and explanatory claims were hegemonic to the extent that it took a cataclysm of the scale and scope of the 2008 global financial crisis—a crisis that continues to try the souls of nations[22]—to create deliberative space for any alternate conceptual thinking.

3. CRITIQUING THE TENSION FRAMEWORK

Fundamentally, the tension framework failed because its explanatory conditions/schemes crumbled under the force of the financial crisis. Its central element—the market-clearing disequilibrium mechanism—failed to adjust excess supply of financial instruments with quantity demanded. That left the "self-correcting" markets unable to correct themselves, let alone return to general equilibrium, as the theory posits. As I noted in the previous chapter, the global economy went off its axis of circulation as a result, a situation that *necessitated* extraordinarily coordinated policy interventions among advanced and industrializing states to avoid "complete seizure of financial markets," deal with their

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[21] The politics of liberalization, privatization and deregulation involved the shedding off of the welfare state's interventionism in the economy, thereby allowing market-driven and market-led competition in the organization of resources across political realms. For details, see Philip G. Cerny, *The Changing Architecture of Politics: Structure, Agency, and the Future of the State* (London and Newbury Park: Sage Publications, 1990), xiv, 53, 204-231; Philip G. Cerny, "Paradoxes of the Competition State: The Dynamics of Political Globalization," *Government and Opposition*, Vol. 32 (1997): 251-274.

[22] The magnitude, intensity, and scope of this crisis reminds us of the good and the hurt as well as the sincerity and hypocrisy that Thomas Paine reflected upon while writing *The American Crisis*, in 1776. The 2008 crisis not only tried "men’s souls," it continues to try the souls of states and supra-nations. But the "peculiar advantage" of crises in general, as Paine noted, is that they are the "touchstones" that bring the "hidden thoughts" of men and women to light. I hope this is true of the 2008 crisis.

indigestible, toxic assets/products while engineering the global economy from the worst possible outcome. Interventions took varied forms, including national financial system rescue packages, deposit insurance purchases, outright purchases of "undigested" securities, massive debt guarantees, capital injection into domestic and global market institutions at near-zero interest rates, long-term purchases of distressed bank assets, rounds of quantitative easing, and fiscal stimulus packages in differentiated sizes. For instance, interventions for banks in the U.S. and U.K. (epicenters of the crisis) and the euro zone amounted to $14 trillion by September 2009, which was about a quarter of global gross domestic product (GDP).[23] The *need for* and *actual* interventions contravene and contradict the tension framework's predictive and explanatory powers because market actors that previously insisted upon the need for greater freedom from political authorities readily transformed themselves into petitioners and welfare clients of their states.

Vindicating the need for intervention was Alan Greenspan's spectacular admission of the flaws of the tension framework—the very framework he helped shape as chairman of the Federal Reserve Board (for almost two decades) and as a renowned practitioner of self-regulating market principles (for more than 40 years). In a Congressional hearing (before the U.S. House Committee on Oversight and Government Reform) on the role of U.S. federal regulators vis-à-vis the global financial crisis, Greenspan declared that he

[23] See Piergiorgio Alessandri and Andrew G Haldane, "Banking on the State," paper presented at Federal Reserve Bank of Chicago Twelfth Annual International Banking Conference on the theme, "The International Financial Crisis: Have the Rules of Finance Changed?" September 25, 2009, available from http://www.bankofengland.co.uk/publications/speeches/2009/speech409.pdf (accessed November 10, 2009); Paul Tucker, "The Repertoire Official Sector Interventions in the Financial System: Last Resort Lending, Market-Making, and Capital," paper presented at 2009 International Conference: Financial System and Monetary Policy Implementation, Bank of Japan, May 27-28, 2009, available from http://www.bankofengland.co.uk/publications/speeches/2009/speech390.pdf (accessed April 26, 2010). See also Martin Sorrell, "The Pendulum Will Swing Back," *Financial Times*, April 8, 2009; Binyamin Applebaum, "Its Forecast Dim, Fed Vows to Keep Rates Near Zero," *New York Times*, August 10, 2011.

"made a mistake in presuming that the self-interests of organizations, specifically banks and others were such is that they were best capable of protecting their own shareholders and their equity in firms."[24] This is a public admission of his personal misunderstanding of the tension framework, and it is a serious indictment because as an economic reporter observes, "markets jumped up or down depending on what Greenspan said."[25] In a more spectacular manner, the admission was a denunciation of the tension framework not because of Greenspan's honored standing as a central banker, but because of his widely celebrated reputation as lead self-regulating market authority.[26]

On theoretical grounds, the tension framework is a neoliberal derivative of realist theoretical construction and, therefore, reflects core realist hypotheses. It does for neoliberals what anarchic theory of international politics does for structural realists. The fundamental assumption of realism is that the interstate system is "anarchic" because it lacks a central, defining authority to shape and enforce its rules. This is the underlying perspective from which realists interpret and analyze international relations. And they do

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[24] See U.S. House Committee on Oversight and Government Reform, "The Financial Crisis and the Role of Federal Regulators," HR 110th Cong. 2nd sess., Preliminary Transcript, October 23, 2008, p. 33, available from http://oversight.house.gov/images/stories/documents/20081024163819.pdf (accessed May 29, 2010). Greenspan's prepared testimony (inserted in the transcript) reads: "those of us who have looked to the self-interest of lending institutions to protect shareholder's equity, myself especially, are in a state of shocked disbelief" (see p. 17). For media reports on the testimony, see Edmund L. Andrews, "Greenspan Concedes Error on Regulation," *New York Times*, October, 23, 2008; Kara Scannell and Sudeep Reddy, "Greenspan Admits Errors to Hostile House Panel," *Wall Street Journal*, October, 24, 2008.

[25] See Andrews, "Greenspan Concedes Error on Regulation." See similar views in Brian Knowlton and Michael M. Grynbaum, "Greenspan 'Shocked' that Free Markets are Flawed," *New York Times*, October 23, 2008.

[26] In my judgment, the best illustrative caption of Greenspan's global reputation is presented in a cover story of a 1999 issue of *Time Magazine*. The magazine honored him as chair of the three-member "Committee to Save the World." The other members of said committee were then Treasury Secretary Robert Rubin and his deputy, Lawrence Summers. For details, see Joshua Cooper Ramo, "The Three Marketeers," *Time Magazine*, Vol. 153, Issue 6, February 15, 1999.

so via tension-clustered terms such as national threat, national conflict, balance of threat, and competitive power politics.[27] By emphasizing these conventional themes, realists have failed (or simply dismiss for theoretical and policy convenience) to conceptualize the diverse identities of states as well as the reciprocity and cooperative behavior among them. Thus, I argue that the tension framework (being a derivative of realism) is what political and financial authorities of mature market states make of their coordinated interests and functions in transforming welfare-oriented, independence experimenting states into neoliberal market-based democracies. Although realism is more about state-state tension while neoliberalism is about state-market tension, both worldviews embed cooperation among states, and between states and markets at different units of analysis.[28]

In other words, the tension framework was designed and engineered in financially powerful liberal capitalist states for subjection of national politics to the logics of global markets. In this sense, the framework embeds coordination of interests and identities of resource-based capitalist states and their global financial market institutions within the wider relations of states as unit actors, and between states and markets (broadly construed). With such embeddings, the basic manifestations of the tension framework

[27] Kenneth N. Waltz, *Theory of International Politics*, especially chapter 6. See also Kenneth N. Waltz, *Man, the State, and War: A Theoretical Analysis* (New York and London: Columbia University Press, 1959); Kenneth N. Waltz, "Realist Thought and Neorealist Theory," *Journal of International Affairs*, Vol. 44, Issue 1 (Spring/Summer, 1990), 35-37; Kalevi J. Holsti, *The State, War, and the State of War* (Cambridge: Cambridge University Press, 1996); Paul R. Viott and Mark V. Kauppi, *International Relations Theory: Realism, Pluralism, Globalism*, 3-4; For a criticism of structural realists starting point of theory, see Wendt, "Anarchy is What States Make of It."

[28] Realist and liberal views of international politics are not the same. While the former offers pessimistic view of states, the latter presents "hopeful prognosis" of cooperation among states. My claim of similarities is based on the tension-themed view that both theories present. On similarities and differences of these worldviews, see Joseph M. Grieco, "Anarchy and the Limits of Cooperation: A Realist Critique of the Newest Liberal Institutionalism," *International organization*, Vol. 42, No. 3 (Summer 1988): 485-507. See also Wendt, "Anarchy is What States Make of It."

did not necessary appear as what they actually are: manifestations of interest and power of globalized states and their financial markets.[29] To paraphrase Kurt Waldheim, the late United Nations Secretary-General, the embedding is a paradox prepared by practitioners of political idealism for practitioners of market realism.[30] The embedded market (first based on gold-dollar exchange and later on floating exchange rate system)—embodied and surreptitiously spread by the U.S. from the post-World War II period through the Washington Consensus—constitutes the latest phase of the international capitalist experience.[31] Britain perfected that experience, which began with seventeenth century Netherlands, and used it (with the gold standard as its super-glue) to reorganize the world economy from the Industrial Revolution through to the interlude of the world wars.

The prime basis of the U.S. spreading the ideological supremacy of the market stems from the fact that the postwar economic and financial system was structured on its domestic policy preferences more than any other country. Reinforcing those preferences

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[29] As Hans Morgenthau observes, "it is a characteristic aspect of all politics, domestic as well as international, that frequently its basic manifestations do not appear as what they actually are—manifestations of a struggle for power." See Hans Morgenthau, *Politics Among Nations: The Struggle for Power and Peace*, rev. Kenneth T. Thompson (Boston and New York: McGraw Hill, 1993), 99. In essence, embedding state-centric struggle for power underscores my argument.

[30] The paraphrase was part of Kurt Waldheim's reflection on the intersection of the idealism of the United Nations Charter and the realism of leading powerful nation-states. See the original words in Kurt Waldheim, "The United Nations: The Tarnished Image," *Foreign Affairs*, Vol. 93, Issue 1 (Fall 1984), 95.

[31] The "Washington Consensus"—the ideological decision to spread market-based democratic governance in a deregulated international economic system—was a set of market-driven reforms designed and implemented primarily by U.S. Government in collaboration with Breton Woods financial institutions and the Washington-based "independent" economic organizations. John Williamson, author of the "Washington Consensus" document noted that the Washington in reference to the Consensus "is both the political Washington of Congress and senior members of the administration and the technocratic Washington of the international financial institutions, economic agencies of the US government, the Federal Reserve Board, and the think tanks." For details, see John Williamson, "What Washington Means by Policy Reforms," Peterson Institute of International Economics, available from http://www.iie.com/publications/papers/print.cfm?researchid=486&doc=pub (accessed January 5, 2009).

was the country's immediate, massive postwar economic size and financial base, which provided a structural and relational power[32] equivalent to that of pre-war Western Europe combined.[33] Such unrivaled power enabled the U.S. to consolidate its postwar hegemony. Indeed, as Marcello de Cecco observes, "any international system composed of unequal partners will be regulated more by the domestic policies of the larger partners than by any specific foreign policy of any of the partners."[34] The country's structural and relational power expanded, at least beyond the early 1970s. This is evident in the fact that by the late 1960s, the total asset of the country's financial institutions was $1,278 billion—three times the total asset of its non-financial institutions. The imbalance exerted a direct force on the country's economic system. In response, policymakers, practicing financiers, and intellectuals sought "a comprehensive understanding of the interrelationships between all types of financial intermediaries" vis-à-vis the broader economy.[35] By inference, the search for *complete understanding of interrelationships* of finance and the real economy provides the most valuable information about the origin and dynamism of the embedded tension framework. Indeed, as Albert Hirschman observed in 1945, "the power to

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[32] Susan Strange defines structural power as the ability to "determine the structures of the global economy within which other states [and] their institutions … have to operate." See Strange, *States and Markets*, 24-29; Strange, "Finance, Information, and Power."

[33] See Charles S. Maier, "The Politics of Productivity: Foundations of American International Economic Policy after World War II," *International Organization*, Vol. 31, No. 4 (Autumn 1977); G. John Ikenberry, "A World Economy Restored: Expert Consensus and the Anglo-American Postwar Settlement," *International Organization*, Vol. 46, No. 1 (Winter, 1992).

[34] Marcello de Cecco, "International Financial Markets and US Domestic Policy since 1945," *International Affairs*, Vol. 52, No. 3 (July 1976), 381.

[35] Murray E. Polakoff et el., *Financial Institutions and Markets* (Boston and New York: Houghton Mifflin, 1970), v. Underhill's assessments reinforces this assertion. He argues: "By the 1960s, particularly in the United States, private financial institutions began to outgrow their local context and to seek a more liberal regulatory regime from their governments." See Underhill, *States, Markets and Governance*, 23.

interrupt commercial or financial relations with any country, considered as an attribute of national sovereignty, is the root cause of the influence or power position which a country acquires in other countries."[36] No doubt the U.S. had that kind of power and influence.

The state-market embedding was enhanced by the underlying complexities of the postwar political economy of interstate relations. Such includes the energy politics of 1970s, North-South economic divide, stagflation in advanced industrialized states, the rise of monetarism in the academia, the collapse of Bretton Woods gold-dollar exchange regime, and the opening of currency futures markets. Those conditions were conducive for market-driven interstate relations because they made the embedded markets appear not only virtuous, but credible, legitimate, and authoritative.

From conceptual/analytic standpoint, the categorization of "states" and "markets" as homogenous entities in their respective spheres confuses twenty-first century students of IPE. It is puzzling because there are different types of markets and each relates with states (also dissimilar) in fundamentally different ways. There are commodity markets, including markets for precious metals, agricultural products, crude oil, and even human organs, as there are geographically defined markets including, national, sub-national, regional, emerging, and global markets. There are also financial markets of complex subtypes with overlapping products and instruments. Among them are markets for foreign currency exchange, securities, insurance, futures contract, derivatives, stocks, and exchange-traded funds. Although the concept of *exchange* is a basic attribute of all

[36] Albert O. Hirschman, *National Power and the Structure of Foreign Trade*, expanded edition (Berkeley, CA: University of California Press, 1945), 16. For a related argument, see also Peter J. Katzenstein, "International Relations and Domestic Structures: Foreign Economic Policies of Advanced Industrial States," *International Organizations*, Vol. 30, No. 1 (Winter, 1976): 1-45.

markets, the *price mechanism*—the cementing agent of the market system—does not equally define them. The price mechanism is a distinctive feature of financial markets.

Financial markets differ not only because of their imperfections and susceptibility to shocks, but because they are at the heart of the market system. Credit organization—the effective administration of intermediary instrument of exchange—is their peculiar excellence. Financial markets are like ferromagnetic materials in the sense that they produce the strongest force that responds to all magnetic fields of markets. They create the indispensable 'magnetism' (credit), which makes the concept of exchange swift and meaningful in the modern world economy. Their 'ferromagnetic' distinctiveness stems from the fact that efficiency of the market functioning instrument is proportioned by the extent of pragmatic regulatory coordination that occurs between political authorities and financial market authorities. In other words, the price mechanism depends on effective coordination between political hierarchies and financial structures. To emphasize, it is pragmatic regulatory coordination of the *price of credit* (interest rates) that makes the concept of "exchange" a functional, integrating feature of all markets. The efficiency of the price system is, therefore, not a given; it is a political function shared by financial markets.[37] This is why I argue that finance is central to IPE in theory and in practice.

Like markets, states are not only distinguishable from other types of polities such as families, ethnicities, race, social institutions, religious organizations, and empire-like

[37] The fundamental relationship between the price of credit and supply of money hinges on interest rates policy. If supply of money decreases, interest rates go up, and vice versa. And that affects credit organization and the politics of a nation. Thus, interest rates policy, though economic in form, is political in the broadest sense. On the political nature of interest rates policy, see William Greider, *Secrets of the Temple: How the Federal Reserve Runs the Country* (New York and London: Touchtone, 1987), 120.

entities;[38] states are differentiated from one another by their competence creating capacity, economic behavior, political cultures and governmental patterns, structural distribution of power and by *ownership* of their "administrative means." The "state," as Yale Ferguson argues, is burdened with "classic internal" challenges and "incomplete construction" of identities.[39] There are all kinds of states, including autocratic, predatory, socialist, welfare, corporatist, advanced capitalist states, imperialist, neocolonialist, developing, industrializing, autarkic, monarchical, "emerging" market states, "nanny" states, "virtual" (or "globalized") states, "quasi-states," and "hyper-liberal"[40] states of varying sizes, structures, sovereign autonomy, legitimacy, influence, authority and degree of capability. Simply put, states do not have real equality in the realm of action. As Samuel Huntington argues, and rightly so:

> The most important … distinction among countries concerns not their form of government but their *degree of government*. The differences between democracy and dictatorship are less than the differences between those countries whose politics embodies consensus, community, legitimacy, organization, effectiveness, stability, and those countries whose politics is deficient in these qualities.[41]

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[38] As Cerny explains, states are "in legal and philosophical principle (and to some extent in practice) both discrete and autonomous, in that they are not subordinate to, incorporated within, nor morphologically determined by (structurally subsumed into) other organizations, institutions, or structures." See Cerny, "The Competition State Today," 6. However, for the sake of conceptual distinctions and theoretical coherence, we need to know the kind of states that are in *absolute tension* or in *creative tension* with markets. Quasi-states, for instance, do not encounter the same level of tension with derivative markets as in the case of advanced liberal capitalist states.

[39] Yale H. Ferguson, "The Crisis of the State in a Globalizing World," *Globalizations*, Vol. 3, No. 1 (March 2006), 7.

[40] On hyper-liberal states, see Robert W. Cox, "The Global Political Economy and Social Choice," in *The New Era of Global Competition: State Policy and Market Power*, ed. Daniel Drache and Meric S. Gertler (Montreal: McGill-Queens University Press, 1991), 342-344. About "quasi-states," see Robert H. Jackson, *Quasi-States: Sovereignty, International Relations, and the Third World* (Cambridge: Cambridge University Press, 1990).

[41] Samuel P. Huntington, *Political Order in Changing Societies*, with a New Foreword by Francis Fukuyama (New Haven: Yale University Press, 2006), 1 (emphasis added).

Indeed, states do not have the same capability or equal sovereignty—a concept Stephen Krasner argues is an age-old "organized hypocrisy").[42] The organizing principles of states differ and overlap because they have power and capability asymmetries. Thus, the extent of governmental capacity or operating system characteristic of a state is vital for any logical analysis. For instance, the "virtual state" is one that has "downsized its territorially based production capability" and has liberated itself from the land.[43] "Quasi-states" or what I call independence experimenting states, on other hand, are politically and economically fragile and have never really gotten out of their survival mode since they were created or externally imposed. They do not have equal relations with the powerful ones. Neither do they have equal interactions with markets, as in the case of hyper-liberal, "virtual," "globalized" or "empire-states." For instance, while virtual states are market price makers; independence experimenting states are market price takers.

Restated, states with varying capabilities do not relate with all types of markets under the same circumstances. Even the most powerful, well-equipped and resource-based states do not relate with derivatives markets (what Gretchen Morgenson calls "multisyllabic wonderment" markets) the way they relate with labor markets in a globalizing world economy in which jobless growth, outsourcing, unemployment, wage differentials, income inequality and old age concerns hardly receive speedy political

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[42] Krasner defines "organized hypocrisy" as "the presence of age-standing norms that are frequently violated," which, however, are enduring attributes of international relations. One of those enduring norms in international studies, as the title of his work highlights, is the concept of "sovereignty." See Krasner, *Sovereignty: Organized Hypocrisy*, 9. Krasner made a similar argument in his "Sovereignty," *Foreign Policy* (January/February, 2001): 20-29.

[43] Richard Rosecrance, *The Rise of the Virtual State: Wealth and Power in the Coming Century* (New York: Basic Books, 1999), 4.

attention.[44] Thus, all things considered, *unit level distinction and analysis* of states matters. Without it, we will take for granted that "tension" is applicable to every state under all circumstances. We will also presume that the efficiency of the price adjusting mechanism is a given, which is not. Determination and management of the intermediary mechanism of exchange is an economic process that is political in essence.

In short, the framing of state-market relations in broad, tensile terms embeds the nature and understanding of IPE. That is the burden of the tension framework: it does not explain state and market relations at specific units. To overcome this burden, we need to differentiate and analyze identities and interests of our analytic units. That is what the marketplace framework is about. And that is why it allows a better understanding of IPE.

4. THEORETICAL DIFFERENTIATION

The marketplace framework is similar, but significantly different from Underhill's "state-market 'ensemble' or condominium" theory.[45] The foundation of his theory is the explicit rejection of the logic of independent existence of states and markets. His theory thus contrasts with the tension framework. In fact, he contends that states and markets are not "*separate* things," but the "sum" of the whole "process of governance" embedded in the wider social whole. As he rightly put it, if indeed "we really do have a *political economy*, we must demonstrate, empirically and conceptually, how the whole is greater than the sum of its parts, *how* states and markets are integral to each other in the process of

[44] On the nature of derivatives markets, see Morgenson, "3,000 Pages of Financial Reform, But Still Not Enough." On states and labor markets, see John Myles and Jill Quadagno, eds., *States, Labor Markets, and the Future of Old-Age Policy* (Philadelphia: Temple University Press, 1991).

[45] Underhill, *States, Markets and Governance*, 7.

governance."[46] In other words, states and markets are conjoined institutions in the dynamic realm of governance. They are, in fact, consanguineal governing entities.

Underhill's methodological *holism* of states and markets, in theory and in practice, is right on the mark. They are inseparable because neither has autonomous existence or a logic of its own. They are a "condominium" and, indeed, an "ensemble" of governance. Their independent existence is what political actors and market authorities make of their holistic nature/functions. As Underhill pointed out, "how 'we' as a society think about states, markets, and governance affects what we believe 'we' can do about them."

However, conceptualizing "states" and "markets" in such broad terms falls back into same intellectual quagmire as the tension framework. As I noted earlier, markets are not the same and the price system is guaranteed via pragmatic regulatory coordination between politics and finance. Regulatory coordination generates broad base social capital, impersonal trust, systemic confidence and integrity necessary for competitive economic processes within the capitalist system. Competition elsewhere requires a corresponding coordination somewhere in order to make "freewheeling capitalism" possible.[47] The "state-market condominium" theory does not make this analytical distinction clear. The lack of distinction 'embeds' relations of advanced capitalist states and their financial market institutions the same way the tension framework embeds them.

[46] Underhill, *States, Markets, and Governance*, 15.

[47] For pragmatic regulatory coordination in practice, see United States General Accounting Office, *Financial Regulatory Coordination: The Role and Functioning of the President's Working Group* (Washington, D.C.: General Accounting Office, 2000). This was a report to the Chairman of U.S. House of Representatives Subcommittee on Capital Markets, Securities and GSEs, Committee on Banking and Financial Services. See also C.A.E. Goodhart, *Some New Directions for Financial Stability?* (Zurich: The Per Jacobson Foundation, 2004); Adair Turner, "How to Tame Global Finance," *Prospect*, Aug., 27, 2009; "Regulating the City in the UK's Interest," *Financial Times*, Sept. 20, 2009. On freewheeling capitalism, see Thomas Friedman, "Are We Going to Roll Up Our Sleeves or Limp On?" NYT, Sept. 20, 2011.

In this sense, the marketplace framework diverges from the condominium theory on two other levels. In fact, they have different *intrinsic values* and different *units* of analysis. The utilitarian end of the state-market ensemble (a macro-unit analysis) focuses on normative issues of state-market governance in an increasingly globalizing political economy. Put another way, Underhill's theory centers on "the appropriate nature of governance" with the best potential for improving our 'disordered' globalizing world. Its prime aim is sustainable governance.[48]

The marketplace framework, on the other hand, is implicit on such normative concerns and rather focuses on *units of analysis* that are prerequisites for understanding the nature of the IPE. "Understanding," as Wolfgang Pauli was referenced to have noted, "means nothing more than having whatever ideas and concepts are needed to recognize that a great many *different phenomena are part of a coherent whole*" (emphasis added).[49] And "the whole is understood by studying its elements in their *relative simplicity* and by *observing the relations between them*" (emphasis added).[50] From this viewpoint, relations between advanced liberal capitalist states and their financial markets offer that relatively simplistic, but unique phenomena in the coherent international political economy. That is

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[48] Underhill, *States, Markets and Governance*, 14; Geoffrey R.D. Underhill, "Introduction: Conceptualizing the Changing Global Order," in *Political Economy and the Changing Global Order*, ed. Richard Stubbs and Geoffrey R.D. Underhill, 3-23; Geoffrey R. D. Underhill and Xiaoke Zang, "Introduction: Global Market Integration, Financial Crises and Policy Imperatives," in *International Financial Governance under Stress*, ed. Geoffrey R. D. Underhill and Xiaoke Zang (Cambridge: Cambridge University Press, 2003), 3-7. See also Geoffrey R. D. Underhill and Xiaoke Zang, "Global Structures and Political Imperatives: In Search of Normative Underpinnings for International Financial Order," in *International Financial Governance under Stress*, ed. Geoffrey R. D. Underhill and Xiaoke Zang, 77-97.

[49] Quoted in Waltz, *Theory of International Politics*, 9.

[50] Waltz, *Theory of International Politics*, 39.

to say the particular conception of relations between advanced liberal capitalist states and their financial markets is central to "the total conception"[51] of IPE. Relationship of these relatively simplistic units reveals the true nature of political economy, which in turn, helps to frame the most effective governance scheme that the state-market condominium theory seeks to advance. Viewed from this perspective, a first-order relationship exists between the marketplace framework and the state-market ensemble in the sense that the latter is best understood when the underlying principles of the former are determined.

In sum, while the state-market ensemble is about understanding political economy by focusing on governance, i.e., how society is/or should be ordered and structured with authority, the marketplace framework is about comprehending political economy by first analyzing its essential relative units. There is the need to maintain analytic distinctions between states and between markets even though both are about governance.

5. CONCLUSION: WHAT THE MARKRTPLACE FRAMEWORK IS NOT CLAIMING

The marketplace framework is not claiming that tension does not exist between what Underhill calls "private passions and interests of individuals, and the collective needs of the wider community."[52] Neither does it argue that tension does not define relations between states and markets in the broader sense. Of course, *absolute* as well as *creative* tension exists between the pursuit of self-interest and production of public goods at

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[51] Karl Manheim, *Ideology and Utopia: An Introduction to the Sociology of Knowledge* with Preface by Louis Wirth (New York: Routledge, 1936/1997), 57. The "particular conception" in this sense could be likened to the significant "tree species" that makes up a "forest" (the whole conception). On the metaphors of trees and forest, see Leander, "Why We Need Multiple Stories about the Global Political Economy," 323.

[52] Underhill, *States, Markets, and Governance*, 13.

different levels in the political economy. The marketplace framework is not about *how* to resolve those tensions, real or perceived. Neither is it explicitly concerned with normative implications of the tension framework. The dissertation simply contends that the central assumptions that underpin the tension framework are inadequate for explaining the nature of relations between states and markets at *distinctive*, unambiguous units of analysis—i.e., relations between advanced liberal capitalist states and their financial markets. Such distinctive unit analysis helps us understand the actual nature of IPE.

That said, the next chapter examines the ideological/intellectual and historical origin of the finance-market-driven mentality. As Stephen Gill and David Law argue and rightly so, "political economy requires analysis of the way in which ideas about what constitutes the *political* and the *economic* have emerged historically" (emphasis in the original).[53] That is to say history rewards research, notwithstanding its epistemological, methodological and ideological constraints.

[53] Stephen Gill and David Law, *Global Political Economy, Perspectives, Problems, and Policies* (Baltimore: John Hopkins University Press, 1998), xviii.

CHAPTER 3

THE ORIGIN AND DOMINANCE OF THE TENSION FRAMEWORK

> Shall I by justice reach the higher stronghold, or by deceit, and there live entrenched securely? … Well … since the sages tell me that "appearance has more force than reality" and determines our happenings, I had better devote myself entirely to appearances; I must put up a façade that gives the illusory appearance of virtue, but I must always have at my back the "cunning wily fox" of which Archilochus so shrewdly speaks.
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> –Plato[1]

> [T]he "power paradox": effective power is unnoticed power; power observed is power devalued …. The architects of power … must create a force that can be felt but not seen. Power remains strong when it remains in the dark; exposed to sunlight it begins to evaporate …. Power revealed is power reduced; power concealed is power enhanced.
>
> –Samuel P. Huntington[2]

> The most underestimated risk for a politician is over exposure.
>
> –Donald H. Rumsfeld[3]

1. INTRODUCTION

These epigraphs reflect the essence of this chapter: the dominance of the tension framework. The chapter presents the view that political theory—an embodiment of political thought—informs public policy, and that the vital role of a theoretical apparatus in policy design for democracy, often, is to embed policy goals and objectives in order to generate public support. It is in this context Rumsfeld advises that policymaking, like

[1] Plato, *The Republic*, translated with an Introduction by Desmond Lee, 2nd ed., reprinted with additional revisions (London, 1987), 52-53.

[2] Huntington defines "power paradox" as "the coexistence … of antipower ethic with inequality in power." This form of power is effective because of its unseen nature. See Samuel P. Huntington, *American Politics: The Promise of Disharmony* (Cambridge, MA: Harvard University Press, 1981), 75-76.

[3] See "Rumsfeld's Rules: Advice on Government, Business and Life," *The Wall Street Journal* (From the WSJ Opinion Archives), January 29, 2001.

"sausage making," should not be seen "close-up" in a democratic society because the greatest risk for a politician is overexposure. This means the basic manifestations of public policy in a democracy should be more apparent than real. To do that architects of political power must construct gaps between political ideals and political practices, for as Huntington argues, power's "visibility is its greatest vulnerability…; to cover up power becomes the first imperative of power."[4] That is to say, power is effective when it is hidden; it loses efficacy when exposed to light. Thus, embedding power in conceptual and theoretical frameworks is the first step towards public policy effectiveness.

From this perspective—the perspective of embedding power—that the chapter explores the historical origins and development as well as the eventual appropriation of the notion of 'tension' as an organizing principle of "virtual states"[5] under the umbrella of globalization and transnationalism. It focuses on evolution of processes that made the tension framework and its rational market theory hegemonic. To grasp these dynamics requires an understanding of the nature and structure of state-centric politics as we have come to know it. That takes us to the emergence of what Hedley Bull refers to as

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[4] Huntington, *American Politics*, 78. Morgenthau expressed a similar idea when he notes that the nature of politics (domestic as well as international) very often requires that its basic manifestations do not appear as a struggle of power. "Rather, the element of power as the immediate goal of the policy pursued is explained and justified in ethical, legal, or biological terms. That is to say *"the nature of policy is concealed by ideological justifications and rationalizations."* See Morgenthau, *Politics among Nations: The Struggle for Power and Peace*, 99. On the paradox of democratic governance and the so-called "voter irrationality," see Bryan Caplan, *The Myth of the Rational Voter: Why Democracies Choose Bad Policies* (Princeton: Princeton University Press, 2007).

[5] The term "virtual states," as used here, reflects the implicit and explicit views of some scholars about globalization of markets. Susan Strange argues: "it is very often easily forgotten that markets exist under the authority and by permission of the state, and are conducted on whatever terms the state choose to dictate or allow." See related views in Susan Strange, *Casino Capitalism* (Oxford and New York, 1986), 29; Susan Strange, "The Persistent Myth of Lost Hegemony," *International Organization*, Vol. 41, No. 4 (Autumn, 1987): 551-574; Eric Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (New York: Cornell University Press, 1994), 2-3. In essence, a "virtual state" operates on "imperial norms" and pretentions. On this, see Rosecrance, *The Rise of the Virtual State*, 16.

"society of states."[6] The chapter explores the idea of tension as the dominant framework of world politics, with emphasis on the growth of financial capitalism and economic nationalism. The purpose is three-fold: First, the chapter outlines how major political entities in the history wrapped their self-interests around the concept of "tension" as a strategic tool for political action. Secondly, the chapter elaborates on how the concept was regurgitated, adapted, and buried in public consciousness as the normal state of international relations; and third, how the concept shaped IPE in theory and in practice.

2. THE NATURE AND STRUCTURE OF STATIST POLITICS

Scholars generally agree that the European states system or society of states began with the Peace of Westphalia (1648), which ended the Thirty Years War and the hegemonic ambitions of the Holy Roman Empire. As Adam Watson noted, the Peace of Westphalia marked "the effective establishment of a Europe of legitimately independent states that recognized each other as such."[7] The key element of that peace was the declaration that the religion of a sovereign ruler be the religion of his territorial realm. Two derivatives from that declaration—territorial sovereignty and non-interference in the realms of other legitimate rulers—became the foundation structures on which the Westphalian system was legislated into existence. What this means, in effect, is that the Peace of Westphalia legitimized precedence of state rights over the universal rights of individuals and all other

[6] Hedley Bull, *The Anarchical Society: A Study of Order in World Politics*, with a Foreword by Andrew Hurrell and Stanley Hoffman, 3rd edition (New York: Columbia University Press, 2002), 8, 13.

[7] Adam Watson, *The Evolution of International Society* (London and New York: Routledge, 1992), 182. Recognition of statehood is determined by other states when they declare to "treat an entity as a state." That is to say "recognition by other states is merely 'declaratory,' confirming that the entity is a state, and expressing the intent to treat it as a state." For details on statehood, see Barry E. Carter, Philip R. Trimble and Curtis A. Bradley, *International Law*, 4th ed. (New York: Aspen, 2003), 436-437.

sectional elements and associations within the state.[8] In effect, state-centric politics has been conceptually designed, virtually organized, and practically reinforced as a "Janus-like structural" system with contrasting spheres: the domestic/internal realm verses the foreign/external sphere.[9] The internal or 'vertical/internal' realm is conceived as rooted in relatively rigid geographical places and governed by hierarchically 'defined' political authority. The virtual (or 'horizontal/outside') sphere is conceptualized as anarchical and quite ungovernable. That is to say the international sphere is conceived and analyzed as an abstract, competitively unregulated realm where states' action and inaction are guided by national interests. Thus, the two realms are fundamentally distinct and contradictory, yet inseparably interwoven and mutually dependent. As such, human as well as material relations are "bifurcated"[10] between them in a Hobbesian "self-regarding" state system.

Broadly speaking, this conceptual framework has been the source of political (in)stability, organizational chaos, social disharmony, and perpetual search for static equilibrium within and across the two realms. It has been so because the state—until recently the primary object of study in world politics—has a binary, contradictory responsibility toward the 'inside' and 'outside' spheres. The regulated realm is the state itself—the site of decisive "collective action, collective decision-making, and policy

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[8] See David Boucher, "Resurrecting Pufendorf and Capturing the Westphalia Moment," *Review of International Studies* 27 (2001), 560; Clive Parry, cited in Richard W. Mansbach, Yale H. Ferguson and Donald E. Lampert, *The Web of World Politics: Non-State Actors in the Global System* (Englewood Cliffs NJ: Prentice-Hall, 1976), 7.

[9] I borrowed these terms, including the "Janus-like" concept from Cerny's analysis. The traditional distinction of the state system based on the Janus-like structure is no longer a universally accepted category, for as Cerny argues, the state is not 'withering away,' yet it is "increasingly enmeshed in a denser and more complex set of virtual political spaces." See Cerny, "Neoliberalisation and Place," 13-15. For an earlier version of this argument, see Philip G. Cerny, "Globalization and the Changing Logic of Collective Action," *International Organization*, Vol. 49, No. 4 (Autumn, 1995): 595-625.

[10] Cerny, "Neoliberalisation and Place," 15; Cerny, *Rethinking World Politics*, 42. See also James N. Rosenau, *The Study of World Politics: Theoretical and Methodological Challenges*, Vol. I (London and New York: Routledge, 2006), 14.

implementation."[11] Thus, the widely held view in world politics is that the state is the ultimate repository of power, authority, legitimacy, and loyalty. This is because it is conceived of as the definitive source of social, economic, and political organization. As a result, the pursuit of such political ideals as justice, equality, and fairness takes place within it. In view of that, political authorities are *obliged* in principle and in practice to create enabling conditions within the regulated realm for the fulfillment of those ideals.

The state's other responsibility is to protect the domestic sphere from the interests of other states through application of power. This way, the state is conceptualized as a rational unified actor, which relies on its capabilities to achieve immediate and long-term goals. Conceived this way, the purpose of all states, therefore, "is the wish for survival," for the "freedom of choice of any one state is limited by the actions of all others."[12] Waltz explains this notion as follows:

> In domestic politics one of the possible capacities—the use of physical force—is ordinarily monopolized by the state. In international politics, there is no authority effectively able to prohibit the use of force. The balance of power among states becomes a balance of all the capacities, including physical force, that states choose to use in pursuing their goals.[13]

In this frame of thought, political power as a "means to the nation's ends"[14] is the explicit goal of the state. With it come all other forms and processes of leveraged advantage. In effect, the struggle for power as an immediate and ultimate goal is the overriding purpose in international politics.

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[11] Cerny, "Neoliberalisation and Place," 14-17.

[12] Waltz, *Man, the State, and War*, 203-205. A similar position is argued in Viotti and Kauppi, *International Relations: Realism, Pluralism, Globalism*, 52.

[13] Waltz, *Man, the State, and War*, 205. See also Morgenthau, *Politics among Nations: The Struggle for Power and Peace.*

[14] Morgenthau, *Politics among Nations*, 29.

In brief, the dual responsibility of the state accounts for the kind of strategic actions pursued by political authorities since the emergence of the international society. The predominant action has been the continual attempt to fuse the 'inside' and 'outside' realms physically and/or organizationally by restructuring or appropriating parts of the 'virtual' space into vertically organized places. The outcomes were laden with expected strife in the form of nationalist uprisings, irredentists' movements, civil wars, class and ethnic conflicts, and population transfers. As Cerny notes, the consequences of these outcomes were key moments that undermined or reinforced the nation-building projects.

A brief review of selected historical conflicts and wars will help explain the broader context of the 'inside' verses 'outside' political practice. The purpose, as I noted earlier, is to illustrate how the concept of "tension"—wrapped around national interests—featured as the organizing principle in the development and expansion of the European states system. Such is also meant to explain how those expansionary processes fed into continental European political systems in a closed-loop manner, underscoring, therefore, Halford Mackinder's notion of the "struggle for relative efficiency." Emphasis is placed on the international dimensions of the European wars on political alliances as well as territorial and capability redistribution. The antipodean nature of those developments reflects what Cerny refers to as "embedding the nation-state and the states system."[15]

3. STRUCTURAL TENSION AND THE STATES SYSTEM IN HISTORY

Structural tension as the main organizational framework for ordering statist affairs is evident in the emergence, consolidation, expansion, "decay, collapse, and revival" of some major units of the Westphalia system. In other words, the rise and fall of great

[15] Cerny, "Neoliberalisation and Place," 15-19; Cerny, *Rethinking World Politics*, 42.

powers and the accompanying redistribution of territory are classic examples of political tension in the making of the modern world.[16] Up until the Congress of Vienna in 1815, the interstate system was not a quiet one; it was characterized by tension in the form of expressive wars. As national policy came to be based on states' self-interests, the system became a multi-polar structure marked by shifting diplomatic alliances and a relatively stable balance of power scheme. For instance, France's attempts between 1660 and 1763 (particularly under Louis XIV) to fuse the 'virtual' European and North American spaces with its territorially defined realm were met and curbed successfully (in cycles of war) by coalitions of states and empire-like entities that included Britain, the Habsburg Empire, Prussia, and Russia.[17] Russia's expansion southward on the European continent and eastward to Asia (more than any other power) was counterbalanced by Britain as the most successful colonizing power. As the governments of both two states wanted a bipolar balance of power across the continent, they interacted uneasily in those 'virtual' spaces, and so were willing to intervene continually to secure a balance that was commensurate with their interests.[18] The bipolar state of affairs, however, was not possible because of protracted, concurrent conflicts of territorial expansion in Europe and North America. Paradoxically, while those conflicts were relatively stabilized, their inherent tensions

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[16] Paul Kennedy, *The Rise and Fall of the Great Powers: Economic Change and Military Conflict from 1500 to 2000* (New York: Vintage Books, 1987). For details on decay, collapse and revival of some of the major units of the states system, see Alexander J. Motyl, *Imperial Ends: Decay, Collapse, and Revival of Empires* (New York: Columbia University Press, 2001). On political and economic tensions in the making of the modern world, broadly speaking, see Barrington Moore, Jr., *Social Origins of Dictatorship and Democracy: Lord and Peasant in the Making of the Modern World* (Boston: Beacon Press, 1966).

[17] On France's early wars of territorial fusion, see Kennedy, *The Rise and Fall of the Great Powers*, 73-74; Morgenthau, *Politics Among Nations*, 20; Bull, *The Anarchical Society*, 31, 102.

[18] Kennedy, *The Rise and Fall of the Great Powers*, 74.

were projected onto seventeenth and eighteenth century waves of European colonization of Southern Africa, India, Australia, and South East Asia.

The ultimate strategic goals of those wars were sovereign territorial reordering, political regrouping, and capability rearrangement. The territorial fusions in North America ultimately led to the American Revolution, whose radicalism[19] reverberated beyond British political space and fed into European territorial configuration as a whole. With Britain's military strength stretched thin, the thirteen original colonies fell to the Americans. Six years after the Treaty of Paris (which secured independence for the colonies), a long brewing political tension erupted in France—the French Revolutionary Wars—a political cataclysm against monarchical and aristocratic order.[20] Its structural impacts affected established political groupings and social order beyond the continent. As Timothy Tackett pointed out, such modern concepts as liberalism, republicanism, nationalism, abolitionism, feminism, and de-Christianization "were all powerfully propagated, if not invented by the French Revolution."[21] The Napoleonic Wars (1803-1815) rejuvenated these concepts on a grander scale.

The scope and scale of the Napoleon's wars, defined by the number of belligerent states and the intensity of impact, are classic illustrations of the oppositional-duality of statist tension. The warring duality caused a breakdown of the European states system

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[19] Gordon S. Wood, *The Radicalism of the American Revolution* (New York: Vintage, 1991); Gordon S. Wood, "Rhetoric and Reality in the American Revolution," *The William and Mary Quarterly*, Third Series, Vol. 23, No. 1 (January, 1966): 4-32. As Bernard Bailyn (summarized in Huntington, *American Politics*, p. 33) notes, the American Revolution was a "vindication of liberty against power."

[20] Georges Lefebvre, *The Coming of the French Revolution*, trans. R. R. Palmer, with a New Introduction by Timothy Tackett (Princeton: Princeton University Press, 1947/2005).

[21] See Timothy Tackett's "New Introduction" to Georges Lefebvre's *The Coming of the French Revolution*, vii.

and ended the century and half old multi-polar balance of power structure that marked the preceding epoch. The wars not only caused unprecedented reordering of European political map, they underpinned the altering sets of coalitions of political entities in the Atlantic world. Napoleon's attack on Spain and the collapse of the Holy Roman Empire resounded across Latin America and opened windows for revolt and territorial reshuffle in the Spanish colonies. Still in the Americas, Napoleon's failure to subdue the Haitian Revolt (1791-1804) weakened France and made the Louisiana Purchase possible. This development added about 828,000 square miles (presently an area of fourteen states) to U.S. political geography. As Colin Elman pointed out, that single purchase was the first and largest step on U.S. path to "regional hegemony."[22] He is right, as the chapter shows.

When the Napoleonic "imperium" finally ended, European sovereigns, statesmen, politicians, ministers, and representatives assembled in congress in Vienna in the fall of 1814 with an overriding objective: to "institutionalize their desire to restrain warfare" on the continent (Richard Langhorne) and establish a "durable settlement" of peace.[23] That desire crystallized in a collective security institution—the Concert of Europe (1815-1914)—an institution, which Langhorne argues was the most successful ever created for regulating international politics.[24] The mechanism that made the Concert of Europe effective was the balance of power among the five most powerful nations at that time: Britain, Russia, Austria, Prussia, and France.

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[22] Colin Elman, "Extending Offensive Realism: The Louisiana Purchase and America's Rise to Regional Hegemony," *American Political Science Review*, Vol. 98, No. 4 (November 2004), 568.

[23] Robert Ergang, *Europe since Waterloo*, 3rd edition (Lexington, MA: D. C. Heath, 1967), 27.

[24] The Concert of Europe had limited jurisdiction over territories outside Europe, including Turkey. See Richard Langhorne, *The Collapse of the Concert of Europe: International Politics, 1890-1914* (London: Macmillan Press, 1981), 4.

A striking feature of the Concert of Europe was the preservation of the status quo power structure that existed before the outbreak of the Napoleonic wars. Within that structure was the concept of 'restraint' in defined territories/regions outside of Europe, an important feature the preceding multi-polar balance of power lacked. The maintenance of the power structure and the concept of restraint cemented the Concert of Europe in the sense that they compensated for the power imbalance that existed among the leading states.[25] While those mechanisms helped stabilize the state system in Europe, their inherent paradox enabled exportation of the system's organizational structures to regions outside of the Europe, including Turkey—territories where the Concert of Europe had established 'limited jurisdiction.' This was largely due to technological advances and the growth of industrial capitalism. In effect, the open political tension that the Concert of Europe had suppressed was revived in the realm of economic nationalism, which the great powers carried out on the waves of a new imperialism.[26] The first major imperial clash to test the resilience of this peace institution was the Crimea War, which involved Britain, France, and the Ottoman Empire on one side, and Russia on the other side.

Those imperialist pursuits and their inherent economic nationalism resulted in a redistribution of power and capability among the European states. The decisive factor was the shift of the continental balance of power in Germany's favor. Germany's pre-eminence was the result of a number of converging factors, including its relatively superior technological progress and its industrial and financial power. Its presence in the

[25] Langhorne, *The Collapse of the Concert of Europe*, 4. France was included in the status quo power structure even though it was defeated, and regardless of the fact that Napoleon caused the war.

[26] J. A. Hobson, *Imperialism: A Study* (New York: Cosimo Classics, 2005); Brian Hudson, "The New Geography and the New Imperialism: 1870-1818," *Antipode*, Vol. 9, Issue 2 (September 1977): 12-19; William L. Langer, *The Diplomacy of Imperialism 1890-1902*, 2nd edition (New York: Alfred A. Knopf, 1965).

imperial space intensified the already tense relations among the great powers. The uneasy relations brought to the surface systemic uncertainties and contradictions, all of which fed back into the complex political alliances on the continent. The contradictions weighed heavily on the structures of the Concert of Europe. As the structures weakened, the collective security institution collapsed on the eve of World War I. In any event, the collective fear of a preponderant state created a period of systemic equilibrium, which lasted from 1815-1914. The deeper causes of its collapse were the troubled interactions of the three big 'isms'—capitalism, economic nationalism, and the new imperialism.[27]

The tensile relation was not different in the interwar period (1918-1939). In the economic realm, it took the form of monetary and financial nationalism, which eventually caused the Great Depression. The political realm was characterized by the collapse of the League of Nations—the idealist institution intended to maintain international stability and peace. The League failed to deal with a number of conflict-related developments that led eventually to World War II. In brief, the world wars were manifestations of political tension on the world stage. The establishment of the Bretton Woods system was an attempt to moderate that never-ending tension. However, the structures of that system never fully consolidated when the hopes and aspirations it embodied were cast into three tension-related dimensions: decolonization, the Cold War, and Non-Aligned Movement (NAM). We shall examine them briefly and concurrently.

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[27] See Robert Ergang, *Europe Since Waterloo*, 352-368; Rudolf Hilferding, *Finance Capital: A Study of the Last Phase of Capitalist Development*, edited with Introduction by Tom Bottomore, trans. Morris Watnik and Sam Gordon (London and Boston: Routledge & Kegan Paul, 1981); V. I. Lenin, *Imperialism: The Highest Stage of Capitalism*, New Edition (New York: International Publishers, 1969); Langer, *The Diplomacy of Imperialism 1890-1902*.

4. DECOLONIZATION, THE COLD WAR, AND NON-ALIGNED MOVEMENT

The first dimension of the post-World War II structural tension was the end of formal European empires and the birth of independence experimenting states in Southeast Asia and Africa. The second dimension was the Cold War, which was an ideological struggle between capitalist and communist coalitions. The third component was the emergence of the NAM or the so-called "Third World"—a euphemistic term for a political movement composed largely of decolonized territories.[28] While decolonization and NAM were relatively regional and continental in dimension, the Cold War was global and militaristic in nature. Decolonization—the nationalist struggle for political liberation from colonial relations—was about disentangling 'former' dependently structured realms from relatively established European territorial spheres. The Cold War was about fusing the decolonized realms into the two ideological camps: capitalist democracy and communism/socialism.

Between the ideological groupings was the NAM, which acted officially as ballast in the geopolitical equation of the grandest "ideologisation" (Cerny) of world politics. The paradox of the Cold War is that while it brought the world close to a nuclear disaster, it also integrated the world through technological and economic competition. In fact, its integrative nature made the traditional distinction between domestic and foreign political spaces fuzzy to the extent that international relations and foreign policy experts could no longer isolate 'domestic/inside' issues from 'foreign/external' events and processes in any convincing way. A consciousness of the interactive processes in both realms—with their rooted inconsistencies and uncertainties continually resurfacing—came to occupy attention of scholars, analysts, and policymakers. Such induced simultaneous analytical

[28] Cedric Grant, "Equity in International Relations: A Third World Perspectives," *International Affairs*, Vol. 71, No. 3 (1995): 567-587.

consideration of events, issues, and processes in both spheres. Over the years, new concepts, neologies, models, and theories were fashioned out to explain such complex dynamics, turbulent developments, and interrelated trends.[29] They include "transnationalism" (Robert Keohane and Joseph Nye), Competition State (Cerny), "transgovernmental networks" (Annie-Marie Slaughter), "turbulence theory" (James Rosenau), "governance without government" (Rosenau) and recently "fragmegration" (Rosenau) and "fission-fusion" processes (Ferguson and Mansbach).[30] One of the latest theories is Cerny's "transnational neopluralism," a theory that deconstructs the hegemonic assumption of "two distinct yet coexisting political processes" working simultaneously in modern world politics.[31] All of these intellectual endeavours aimed at making sense of the inherent tension that has shaped and defined the practice of international politics.

5. RELEVANCE OF THE HISTORICAL REVIEW

The benefit of this sweeping historical review, as noted at the beginning of this chapter, is three-fold. First, it shows the nature and development of the concept of tension as the defining analytical framework for the study international politics. It illustrates how major sovereign states in history owed their territorial domains as well as their very existence to

[29] Manning, "The Congress, the Executive and Intermestic Affairs," 306-324. See also Michael Cox, Ken Booth and Tim Dunne, "Introduction: The Interregnum: Controversies in World Politics 1989-1999," *Review of International Studies,* Vol. 25, Special Issue (December 1999): 3-18.

[30] Joseph S. Nye, Jr. and Robert O. Keohane, "Transnational Relations and World Politics: An Introduction," *International Organization*, Vol. 25, Issue 3 (Summer 1971): 329-349; Rosenau, *Turbulence in World Politics*; James N. Rosenau, "Governance, Order and Change in World Politics," in *Governance Without Government: Order and Change in World Politics*, ed. James N. Rosenau and Ernst-Otto Czempiel (Cambridge: Cambridge University Press, 1993); James N, Rosenau, *Distant Proximities: Dynamics beyond Globalization* (Princeton and Oxford: 2003), 11; Annie-Marie Slaughter, *A New World Order* (Princeton: Princeton University, 2004), 107; Ferguson and Mansbach, *Remapping Global Politics*, xii.

[31] Cerny, *Rethinking World Politics,* 3.

conquests and expansion.[32] They did so by wrapping their self-interests around tension as the main instrument for strategic political actions. The threat (genuine or perceived) to the security of a state or to the peace of the states system was girded with it. Second, the survey demonstrates how the idea of tension in state-centric organization has long been shaped, adapted, and buried in the realm of public perception in ways that have been accepted with "blissful unawareness."[33] In fact, it is within this framework that territorial (re)structuring of society was generally acknowledged as a state of nature, state of war, and the miseries of humankind.[34] In other words, through this framework that the basic problem of our "political universe" has become "the management of violence and war."[35] The result of this state of mind is that world politics as well as the political economy of international relations have been conceptualized through the established lenses of tension.

The third significance of the survey is the very focus of this chapter; i.e., how the Janus-like tension came to be appropriated for the study of political economy of interstate relations. That is to say the idea of tension has been regurgitated from 'high' politics of security-centric analysis to 'low' politics of market-driven relationships in the system of states. But unlike 'high' politics where "iron sharpens iron," the state-market dynamic is about the infallibility of market forces over political institutions. At the heart of this *infallible* framework is the rational market hypothesis—the doctrine that "market

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[32] Albert Einstein, "Why Socialism," *Monthly Review* (May 1949), 9.

[33] See Louis Wirth's Preface to Karl Manheim's *Ideology and Utopia*, x.

[34] See Waltz's *Man, the State, and War*, and Holsti's *The State, War, and the State of War*. See also Josef Joffe, "Rethinking the Nation-State: The Many Meanings of Sovereignty" (Review Essay), *Foreign Affairs* (November/December 1999), 123; Wendt, "Anarchy is What States Make of It."

[35] Ferguson and Mansbach, *Remapping Global Politic*, 3.

exchange is … capable of acting as a guide for all human action."[36] The emergence of this doctrine complicated the Janus-like ordering of society. How and why this relatively unfamiliar mode of ordering society became a reality on the international political economy landscape is explored in the section that follows.

6. STATES VERSUS MARKETS ON THE SIAMESE STRUCTURE

The tension premise was advanced to facilitate organization of society from *security-oriented*, vertically structured welfare states into market-driven, horizontally ordered "competition states." We can draw lessons from the epigrams at the beginning of this chapter to explain how and why this transformation happened at the time it did.

The basic lesson from the said epigrams is that state-centric goals in democratic societies are usually advanced when political entrepreneurs are able to *form* and organize citizens to accept preconceived patterns/order as a social reality. In other words, the process of designing theoretical frameworks in democratically organized societies is very often embedded with intractable "social constructions" of knowledge and power relations that are not easy to detect and recognized as constructs.[37] In fact, this argument is in line with Plato's idea that "appearance has more force than reality" and that a façade makes "illusory appearance" more virtuous. It is also in tune with Huntington's advice that the architects of power must obscure power by denying the facts of power. In other words, power becomes effective when structured as a façade. In this sense, the regurgitation and

[36] David Harvey, *A Brief History of Neoliberalism* (Oxford: Oxford University Press, 2005), 3. For a detailed analysis of efficient markets, see Justin Fox, *The Myth of the Rational Market: A History of Risk, Reward, and Delusion on Wall Street* (New York: HarperCollins Publishers, 2009).

[37] See Anne Larason Schneider and Helen Ingram, *Policy Design for Democracy* (Lawrence, KS: University of Kansas Press, 1997), 106-107.

appropriation of markets as entities in dynamic tension with political institutions is a form of Platonic façade. To construct a dynamic façade, however, requires a range of concepts, assumptions, and vocabularies that readily appeal to citizens' cultivated habits and doctrinal instincts. The success of a social construction depends, therefore, on the extent to which citizens are *formed*. As Jean-Jacques Rousseau pointed out, the *forming of citizens* is crucial for the endurance of the state (emphasis added).[38] His point is, thus, consistent with the broader themes of the epigrams.

In other words, to effectively implement state-centric policies, power must be embedded in familiar themes and ideas. As Robert Green argues in *The 48 Laws of Power*, "ideas are most easily communicated through metaphors and imagery."[39] In the context of our analysis, the metaphors and imagery for embedding the state-market tension include competition, conflict, and balance of power. As I indicated earlier, these tension-clustered concepts are the windows to hegemonic worldviews. Appropriating them into the study of political economy of international relations was seamless because "tension" has been the dominant prism through which world politics is still analyzed. In effect, the idea of state-market tension gained ready popularity because it is structured on conventional political concepts. Those concepts made the market-driven global political economy conducive, as they made illusory markets appear not only virtuous, but as entities without credible alternatives. We now turn attention to conditions that made it so.

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[38] Rousseau argues: "The fatherland cannot endure without freedom, or freedom without virtue, nor virtue without citizens; *you will have everything if you form citizens*; if you do not, you will have nothing but nasty slaves, beginning with the chiefs of the state. Now to form citizens is not the business of a single day; and to have them be citizens when they are grown, they have to be taught when they are children." See Rousseau, *The Social Contract and Other Later Writings*, ed. and trans. Victor Gourevitch (Cambridge: Cambridge University Press, 1997), 20.

[39] Robert Green, *The 48 Laws of Power* (New York: Penguin Books, 1998), 374.

7. STATE-MARKET TENSION: PRECIPITATING CONDITIONS

The earliest postwar scholarly discussions about state-market relations date back to the late 1960s. This period marked the beginning of debate in the social sciences as to whether IPE should be a subfield of IR or an inter-discipline.[40] Those intellectual deliberations did not come by themselves; they were induced and sustained through the 1970s and beyond by the inconsistencies and uncertainties of increasingly integrating world. The integration, as noted in Chapter 2, was stimulated by a number of interrelated conditions and processes. Among them were the 'fission-fusion' processes of the Cold War, the growing North-South divide, inequities in international economic system, and a general impasse in international trade negotiations. Others included massive deficit financing in developed economies, a growing international debt that confronted newly independent states, the collapse of Bretton Woods fixed exchange rates regime, and the broader transformation of the immediate postwar international economic order.[41]

The dominant intellectual frameworks that guided those discussions were based on the concept of interrelations of international economics and international politics. The central themes included the notion of 'interdependence' and 'transnational interactions' vis-à-vis 'international relations' and the relevance of 'high' versus 'low' politics.[42] The debates were counter-framed along such approaches as "hegemonic stability theory"

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[40] See Underhill, "State, Market, and Global Political Economy: Genealogy of an (Inter-?) discipline."

[41] See Gilpin, *U.S. Power and the Multinational Corporation*; Susan Strange, "The Study of Transnational Relations," *International Affairs*, Vo. 52, No. 3 (July 1976), 335; Philip G. Cerny, "Embedding Neoliberalism: The Evolution of a Hegemonic Paradigm," *The Journal of International Trade and Diplomacy* 2, no., 1 (Spring 2008), 2, 12-13.

[42] See Nye, Jr. and Keohane, "Transnational Relations and World Politics: An Introduction;" Nye, Jr. and Keohane, "Transnational Relations and World Politics: A Conclusion," *International Organization*, Vol. 25, Issue 3 (Summer 1971): 721-747; Underhill, "State, Market, and Global Political Economy."

(Charles Kindleberger), "world-systems theory" (Wallerstein), "neorelism," (Waltz), "embedded liberalism" (John Ruggie) and "liberal institutionalism" (Robert Keohane).[43] These worldviews and the theories that explain them were framed, to a large extent, along traditional 'inside/outside' analytical continuum, which means the analytical issues and processes remained "intergovernmental" and "international" in nature and form.

These paradigms and assumptions as well as their normative and interest-based implications, including unequal distribution of capability in interstate relations, were increasingly questioned.[44] So were the identities and activities of non-state actors and their sources of authority and influence. Analytical and normative constraints such as international public policy choices and processes were closely examined. Some of the early works that reflected broadly on these issues and themes included Richard Cooper's *The Economics of Interdependence*, James Rosenau's edited *Linkage Politics*, and Susan Strange's "International Economics and International Relations: A Case of Mutual Neglect."[45] They explored structural changes in the international system and growing interdependence of national and international actions, processes, and events. These themes largely undercut the established assumptions of policy autonomy of states.

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[43] See Charles Kindleberger, *The World in Depression 1929-39* (Berkeley: University California Press, 1973); Gilpin, *U.S. Power and the Multinational Corporation*; Wallerstein, *The Modern World System*; Waltz, *Theory of International Politics*; John G. Ruggie, "International Regimes, Transactions, and Change: Embedded Liberalism in Postwar Economic Order," *International Organization*, Vol. 36, No. 2, International Regimes (Spring 1982): 379-415; Robert O. Keohane, *After Hegemony: Cooperation and Discord in the World Political Economy* (Princeton: Princeton University Press, 1984).

[44] Nye and Keohane, "Transnational Relations and World Politics: A Conclusion," 721.

[45] Richard N. Cooper, *The Economics of Interdependence: Economic Policy in the Atlantic Community* (New York: McGraw-Hill Book, 1968); James Rosenau, ed., *Linkage Politics: Essays on the Convergence of National and International Systems* (Free Press, 1969); Susan Strange, "International Economics and International Relations: A Case of Mutual Neglect," *International Affairs*, Vol. 46, No. 2 (April 1970): 304-315.

As state-centric conception of politics was changing so the discourse on specific issue-areas and activities of non-state actors expanded. Some scholars focused attention on the sources and nature of hierarchically structured and centrally-directed bureaucratic organizations with specific transnational roles in world politics. Others concentrated on international affairs and processes with differentiated emphasis on the size, nature, and scope of operations.[46] Relations between "states" and "markets" dominated the discourse. Some of the seminal works providing intellectual stimuli in state-market issue-area include Susan Strange's *Sterling and British Policy*, Charles Kindleberger's *Power and Money* and Gilpin's *U.S. Power and the Multinational Corporation*, in which Gilpin defines the political economy of international relations as a reciprocal and dynamic interaction of the pursuit of power and the pursuit of wealth. In fact, the state-market tension is the core of Strange's article, "The Study of Transnational Relations" in which she emphasize "authority/market relationship [rather] than the state/state relationship."[47]

With such influential works, the inside/outside distinction began to make way for inside/market analysis, with market activities across national borders seen and interpreted as inescapable economic reality. In effect, emphasis on the boundaries of world politics began to shift from statist territorial markers into the abstract realms of markets, as the

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[46] Samuel P. Huntington, "Transnational Organizations in World Politics," *World Politics*, Vol. 25, No. 3 (April 1973); Susan Strange, "The Study of Transnational Relations," *International Affairs*, Vo. 52, No. 3 (July 1976).

[47] Strange, "The Study of Transnational Relations," 333-334. Of course, Strange has been acknowledged by fellow scholars as a "states markets scholar." See Underhill, "State, Market, and Global Political Economy: Genealogy of an (Inter-?) discipline," 806. See de Cecco, "International Financial Markets and US Domestic Policy Since 1945."

nature of power was more and more conceived as "inseparably political and economic."[48] These conceptual/theoretical developments effectively marked the birth of IPE as a sub-filed in international studies.

The entry of "markets" into the Janus-like power symmetry as rational entities coincided with structurally transformative, transnational, and globalizing processes and developments. The implications ranged far in theory and in practice, as the fundamental assumptions of state-centered "architecture of politics" had changed into what Cerny calls a "'plurilateral' structure" that includes non-states actors, too.[49] In that sense, states are no longer exclusively conceptualized as unitary actors competing only among themselves; they are in stiff competition with markets as well. In this sense, the bare statist power that shaped interstate relations was now seen as a shared phenomenon between states and markets. Strange refers to this phenomenon as "authority-market and market-authority nexus."[50] Not only was scholarly orientation changing, public focus and perceptions and the broader habits of mind were equally shifting toward the idea of market authority over state power. An analyst described the new dispensation of market authority as a "business theology" in which "The Market as God" knows the "grand narrative about inner meaning of human history," the "creation of wealth [and] the seductive temptations of statism...."[51]

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[48] Gilpin in Strange, "The Study of Transnational Relations," 337, 339. See also Gill and Law, *Global Political Economy*, xviii; Underhill, "State, Market, and Global Political Economy," 805-806.

[49] See Cerny, *The Changing Architecture of Politics*; Cerny, "Globalization and the Changing Logic of Collective Action," 595. Cerny, "Embedding Neoliberalism: The Evolution of a Hegemonic Paradigm," 2.

[50] Strange, *States and Markets*, 22.

[51] The idea of "The Market as God" conveys such divine attributes as omnipotent, omniscient, and omnipresent—attributes that are *there*, but hidden from the eyes of humankind. For details, see Harvey Cox, "The Market as God: Living in the New Dispensation," *Atlantic Monthly* (March 1999): 18, 19-23.

Of course, not all scholars accepted the new intellectual proposition that cast states as losing their authority. Some viewed it with deep skepticism; others rejected it outright with forceful insistence on states as unified actors. For instance, Krasner argues that although the economic structures of the states system were changing as a result of the emergence and activities of non-state actors, the state remains the dominant entity for intellectual analysis. He contends that the claim about the state being "multinationalized, transnationalized, bureaucratized and transgovernmentalized" does not hold because interdependence as a balance-of power strategy is "a reflection of state policies and state choices."[52] Germain, on the other hand, describes the claim of market dominance as "imperial pretentions" embedded in the "economic theory of international politics," with "markets" becoming IPE's central subject of study.[53]

From the late 1970s through the 1990s, a number of scholarly works on specific issue-areas of the state-market relations were added to the growing literature. Those that focus on finance, economic growth and national power include Benjamin Cohen's *Organizing the World's Money*, Joan Spero's *The Politics of International Economic Relations* and John Zysman's *Governments, Markets, and Growth.* Others are Susan Strange's *Casino Capitalism* and *States and Markets*, Philip Cerny's edited *Finance and World Politics*, and Grahame Thompson's edited *Markets: United States and the Twentieth Century*. Although layers of divergence exist among these scholars, the issue of power—its nature, source, implications—and authority were central to their analyses.

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[52] Stephen D. Krasner, "State Power and the Structure of International Trade," *World Politics*, Vol. 28, No. 3 (April 1976): 317. Krasner was right, except that he did not identify the *kind* of states in question.

[53] Germain, *The International Organization of Credit*, xi, 2.

As indicated in the previous chapters, the changing nature of world politics in general and state market dynamics in particular provided grounds for the U.S.—the leading postwar military, economic and financial power—to reorganize and, indeed, integrate the world economy along visible market competition as a reflection of its national value. But the issue of U.S. dominance in shaping the global economy is not a fully settled argument among scholars. While many generally agree on the role played by leading industrialized economies in deregulating domestic financial markets and liberalizing their external control, they are divided as to the actual causes/sources of those developments. For Andrew Sobel, the tension framework (by implication) was nothing more than the result of domestic competition among organized securities markets of major economies, which had a "spill over effect" in the international environment. He termed this process the 'inside-out' explanation[54] of globalization.

Eric Helleiner, on the other hand, argues that the source of financial globalization could be traced to "a combination of structural and ideational" developments within the leading capitalist states. He argues that structural "competitive deregulation"—induced by technological developments—forced states, beginning in the 1960s, to act unilaterally in deregulating markets to attract mobile capital. In other words, ideological shift from postwar Keynesianism to neoclassical or neoliberalism accounted for the emergence of globalization as a foreign policy choice of the major capitalist states. His interpretations of convergence of policy choices may be termed "outside-in" explanation.[55] As he pointed out, the "open global financial order could never have emerged without the

[54] Andrew Carl Sobel, *Domestic Choices, International Markets: Dismantling National Barriers and Liberalizing Securities Markets* (Ann Arbor: University of Michigan Press, 1994), 78.

[55] See Cohen, "Phoenix Risen: The Resurrection of Global Finance," 271.

support and blessing of states."[56] Obviously, the only state with significant amount of international blessing, then, was the U.S.

Analysis elsewhere supports Helleiner's assertion of ideology accounting for the coming of globalization, for the tension framework is, indeed, an "outside-in" occurrence than an "inside-out" phenomenon. The origin (not overt in nature) is traceable primarily to U.S. (and moderately to) U.K. governments' coordinated policy choices through the interaction of their respective market institutions. Such was the case because the postwar economic order reflected U.S. policy agenda more than any other country. Britain played a complementary role, particularly in the opening and operations of Eurodollar markets (see Chapter 6). That is to say globalization of markets via the tension framework is a phenomenon whose comprehension cannot be investigated outside of the policy choices of leading liberal capitalist states, particularly the U.S. The next section explores U.S. sources of restructuring the global political economy and the motivations behind.

8. U.S. POLITICAL IDEALS VERSUS MARKET VALUES

The preceding sections emphasize the view that any scholarly attempt to investigate the dominance of the tension framework and its efficient market hypothesis must be done primarily within the context, influence, and dynamism of U.S. domestic policy in the international economic and financial systems. That investigation must, however, be grounded first and foremost within the tensions and puzzles of American politics. In other words, one needs to understand the workings of the U.S. political system in order to understand its processes and impacts in the political economy of international relations.

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[56] Helleiner, *States and the Reemergence of Global Finance*, vii.

This brings to mind the import of Huntington's statement where he advised that the architects of U.S. power must create a force that can be felt but not seen, for an effective power is one that is hidden from the mass publics. My understanding of the tension-laden nature of American domestic politics is shaped largely by Huntington's concept of the bipolarity of American liberalism.[57] The "central agony of American politics," Huntington writes, is "the widespread gap between American political ideals and institutions—referred to here as 'the IvI gap.'" He continues:

> Awareness of power induces respect, obeisance, fear, awe: power breeds power. In the United States, however, awareness of power induces suspicion, hostility, and outrage. Because of the prevalence of the antipower ethic, awareness of power breeds its own reduction and hidden power is more effective. Because power is less legitimate in the United States than in other cultures, greater efforts have to be made to obscure it. It becomes necessary to deny the facts of power in order to preserve those facts. Yet the opportunities and the pressures to expose and publicize power pervade American life. Consequently … the most effective exercise of power is the concealment of power.[58]

In other words, to preserve power is to deny its very existence. And it is imperative to hide power in the U.S. because of the pervasive opposition to power. The "gap" that emerges between the existence and denial of power makes power effective. Stated in other words, the gap between creedal resistance to power and the general lack of power makes American power unnoticed, yet very robust and effective. In effect, effective power must have two contrasting faces, neither of which should be seen.[59]

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[57] Huntington's concept of "disharmonic polity" is not without serious criticisms. He has been criticized for been so *thin* on historical and sociological foundation of American political ideology. For selected reviews of his book, see Paul C. Nagel, in *The American Historical Review*, Vol. 87, No. 4 (October 1982), 1148-1149, Amitai Etzioni, in *The American Journal of Sociology*, Vol. 88, No. 6 (May 1983): 1296-1297, and Robert A. Devine, in *Political Science Quarterly*, Vol. 97, No. 3 (Autumn 1982): 505-506.

[58] See these quotes in Huntington, *American Politics*, 39, 78.

[59] Peter Bachrachand and Morton S. Baratz, "Two Faces of Power," *The American Political Science Review*, Vol. 56, Issue 4 (December 1962): 947-952. For a similar concept, see Susan Strange,

Huntington has provided the structural determinants of the effectiveness as well as the dominance of American power. The source is its pulsating liberal democratic principles. Its efficacy lies in the gap, the creative tension between political principles and political practice. American's distrust of power is the distinctive feature of the nation's political thought. Americans generally believe that government is the "most dangerous embodiment of power." And indicative of that antipathy to government and power is the "virtual absence of the concept of the 'state' in American thought."[60] The concept of the state, which implies "concentration of sovereignty in a single, centralized, governmental authority,"[61] is antithetical to American liberal creed. In effect, the strength of the American system of government is shaped within this creed. Our concern here is to illustrate how U.S. government-society relations explain state-market relations.

To do so requires an examination of the influence of the American "power paradox" as reflected via the nation's international relations. That can be done by probing into the principles of state-market interactions, having indicated that U.S. domestic policy choices primarily shaped the "inevitable" state-market tension.

I begin this part of the analysis with a derivative claim that the power gap between political thought and market practices creates tensile, disharmonic conditions. Such conditions favor market-oriented organization, which in essence is conflictual with fundamental tenets of the liberal democracy. Disharmonic conditions can be avoided only when state-market relational processes are rooted in organic/social policies, without

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"The Persistent Myth of Lost Hegemony," *International Organization*, Vol. 41, No. 4 (Autumn 1987): 551-574. This observation is in tune with Krasner's central argument in *Sovereignty: Organized Hypocrisy*.

[60] Huntington, *American Politics*, 34.

[61] Huntington, *American Politics*, 35.

which market-driven policies alone lack structural stability and institutional regulatory capacity *necessary* to maintain long-term equilibrium.

To project creative tension, markets were designed to be a symbol of rationality, morality, self-interest, dispersed power, and natural rights as against centralized state authority.[62] Interweaving market values and the notions of natural rights means that markets provide freedom and reward personal responsibility. If the core of constitutional restraint of state power and essence of liberalism is freedom from state control, then markets are the obvious source of liberty because they represent "the free, responsible, self-governing individual … thought … of as self-sufficient."[63] As President James Madison was quoted to have said, "liberty granted charters to power" in America, unlike in Europe where "power granted charters to liberty."[64]

In this sense, the notion of freedom—apparently granted by market institutions rather than by societal-institutions—made the tension framework gain democratic support in the American domestic political arena. In effect, "the gospel of wealth" neutralized the possibility of "a gospel of power."[65] As Strange pithily put it, "market wishes" became more powerful among Americans than the "wishes of policymakers," for the perception was that the tension between states and markets restricted their national policy options, too. But "while this [perception] is not untrue," Strange continues, "the fact is that

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[62] The ideas expressed here are derived from Huntington's analysis of the development of constitutional and political ideas in England and the U.S. For details, see his *American Politics*, 35.

[63] Charles H. Hendel, quoted in Huntington, *American Politics*, 33-34.

[64] James Madison, summarized in Huntington, *American Politics*, 34

[65] For details on the "gospel of wealth," see Andrew Carnegie, *The Gospel of Wealth and Other Timely Essays* (New York: The Century Co., 1901). On the "gospel of power," see Huntington, *American Politics*, 34.

[Americans] are hoist with their own petard: liberalization, privatization and deregulation that brought about this vulnerability to market forces was in large part their own doing." "Conversely," Strange maintains, "it is logical to conclude that it is they—US Presidents and Congress who have the power if anyone has to reverse the process and tip the balance of power back again from market to state."[66] Stated in other words, the U.S. had the power to reverse the dynamism of state-market tension—the basis of the doctrine of deregulation, privatization, and competitive liberalization of national economies. That is to emphasize that the U.S. was the primary source of re-globalization of market forces.

The bottom-line of this section is that the façade of markets as a force for good gave market institutions democratic aura of authority and legitimacy over state power. And the matching habits of mind—the idea of rationality, natural rights, self-interest, individual liberty, and personal rewards that markets guarantee—provided the right countervailing power for the stable domestic political dynamics that the U.S. needed to implement the state-market tension abroad. That is to say the market doctrine that rational individuals do what is in their self-interest—a fundamental element of the American democratic creed—is at the core of the state-market tension, too.

I argue in this sense that the fundamental concepts that made the noumena of American political thought dominant—ideals of liberty, rule of law, egalitarianism, individualism, universalism, and constitutional democracy—also made the phenomena of state-market tension hegemonic. And with coordinated support from other industrialized states, the U.S. was able to package and wrap those ideals—with the hidden gaps and façades—around the political mask of efficient markets and furtively embedded the belief

[66] Strange, "Finance, Information and Power," 266.

in markets as a force for good, particularly among the so-called sovereign, but relatively independence experimenting states. The embedding process and the phases it took are discussed below.[67]

9. EMBEDDING THE TENSION DYNAMICS

The embedding process was carried out in three comprehensive phases. The first phase consisted of facilitating the rise of transnational practices, starting from the end of World War II. To that end, Huntington writes:

> Throughout the two decades after World War II, the power of the United States Government in world politics, and its interests in developing a system of alliances with other governments against the Soviet Union, China and communism, produced the underlying political condition which made the rise of transnationalism possible. Western Europe, Latin America, East Asia and much of South Asia, the Middle East, and Africa fell within what was euphemistically referred to as "the Third World" and what was in a security zone.[68]

This extract provides authoritative evidence regarding the origin, purpose, and direction of postwar transnationalism. The author presents a list of public and private transnational organizations and multinational corporations, most of which have U.S origin to back up his claim. And he delineates the terms and conditions under which those organizations and corporations operated:

> The governments of countries within this zone [i.e., "the Third World" security zone] found it in their interest: (a) to accept an explicit or implicit guarantee by Washington of the independence of their country and, in some cases, of the authority of the government; and (b) to permit access to their territory by a variety of U.S. governmental and non-governmental organizations pursuing goals which those organizations considered important.[69]

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[67] In my view Huntington provides one of the explicit accounts of the nature of transnationalism under U.S. hegemony. See Huntington, "Transnational Organizations in World Politics," 342-35.

[68] See Huntington, "Transnational Organizations in World Politics," 343. This view reflects the broader argument in Maier's "The Politics of Productivity: Foundations of American International Economic Policy after World War II."

[69] Huntington, "Transnational Organizations in World Politics," 343.

Having stated the above, Huntington elaborates on the central element of U.S.-induced transnationalism, an element U.S. foreign policy critics had failed to recognize; he notes:

> Many books have been written describing—and deploring—"the American Empire" which emerged after World War II. These volumes are filled with statistics on U.S. military spending, troop deployments, overseas bases, foreign investments, exports and imports, economic and military assistance. The one statistic that is always missing, however, is that which was always central to descriptions of the British, French, Spanish, or Roman empires: square miles. In contrast to all earlier empires, the American "empire" (if it is even sensible to use that term) was an empire of functions, not territory.
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> …. In the American empire, if it be that, the American presence was thus almost everywhere, American rule almost nowhere. American expansion has been characterized not by the *acquisition* of new territories but by their *penetration*…. Transnationalism is the American mode of expansion. It has meant "freedom to operate" rather than "power to control" (emphasis is original).[70]

Huntington's analysis sums it all. The literature on postwar transnationalism in general and operation and dynamism of market institutions in particular corroborates his claims, including the "gap" between American presence and American rule in the international system. Marshall Windmiller, a professor of International Relations and an early enthusiast and trainer of Peace Corps volunteers, made a similar claim in early 1970s about the relationship between American politics and American businesses when he wrote: "American power expands with a kind of push-pull movement: Government serves business expansion, and business serves the expansion of government power."[71]

Corroborating these views were other distinguished intellectuals of American foreign policy and former senior U.S. government appointees close to the seat of political

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[70] Huntington, "Transnational Organizations in World Politics," 343-344.

[71] Marshall Windmiller, *The Peace Corps and Pax Americana* (Washington: Public Affairs, 1970), 16-17. See also G. Timofeyeva, "Benefactors Deflated," *International Affairs*, Vol. 9 (September 1972): 98-100.

power. Writing about power and interdependence in the age of information revolution, Robert Keohane and Joseph Nye Jr. (former Chairman of U.S. National Intelligence Council, 1993/94 and former Assistant Secretary of Defense for International Security Affairs in the administration of President Bill Clinton) had the following to say about U.S.-induced transnationalism: "the information revolution … can be understood only within the context of the globalization of the world economy, which itself was *deliberately* fostered by U.S. policy and international institutions for half a century after the end of World War II" (emphasis in the original).[72] This is an authoritative declaration.

Indeed, U.S. influence did not come through acquisition of territory, but rather by their penetration. And having penetrated those territories with explicit or implicit consent of their governments (notably those experimenting in independence), it was logical for the U.S. with its transnationalized organizations to determine the terms and conditions on which reproductive relations and general market processes were framed, formulated, and implemented. This form of expansion certainly differed from the way European powers expanded between sixteenth and nineteenth centuries, although the processes in all cases were pluralistic in nature.[73] The strategy of the U.S., however, worked better because it deemphasized military rivalry while projecting market premium. And it was effective because market power is fundamentally a frontage power of powerful capitalist states.

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[72] Robert O. Keohane and Joseph S. Nye, Jr., "Power and Interdependence in the Information Age," *Foreign Affairs* (September/October 1998), 84. See also Gilpin, *U.S. Power and the Multinational Corporation*, for detail analysis.

[73] Ronald Findlay, "Globalization and the European Economy: Medieval Origins to the Industrial Revolution," in *Europe and Globalization*, ed. Henryk Kierzkwoski (New York: Palgrave Macmillan, 2002), 33; David Sylvan, "Periphery, Centre, Mass: Alternative Histories of Europe's Role in Globalization," in *Europe and Globalization*, ed. Henryk Kierzkwoski, 303-311; Kevin H. O'Rourke, "Europe and the Causes of Globalization, 1790 to 2000," in *Europe and Globalization*, 65-86.

The second phase of U.S. transnationalism followed the successful penetration of those countries. Following the end of the Bretton Woods fixed exchange rate system, financial capital became internationalized through currency futures markets (see chapter 5), a development that was compounded by growth and recycling of petrodollars. Having shaped the rules and conditions of territorial penetration, the U.S. and the international economic institutions (both private and public) enabled governments of many of the independence experimenting states (with little or no experience in international politics and diplomacy) to borrow from advanced economies and their credit market institutions to finance their development projects, including import substitution industries. With the International Monetary Fund (IMF) providing needed recommendations and the "seal of approval," the borrowing countries borrowed to the hilt. Their total external indebtedness increased from 64 billion U.S. dollars in 1970 to 686 billion in 1984. At the end of 1989, the debt increased to 1,290 billion. About one-half of this debt was owed to private international financial institutions of developed economies.[74]

The consequence of repaying those debts, from developing countries perspective, was devastating in at least two ways. First, a number of the debtor countries spent more than half of their gross national income (GNI) to service their indebtedness, doing so at the expense of providing basic infrastructure and essential social services. Others were unable to service their debt because of shortfalls in projected revenue and, therefore, had

[74] See G. C. da Costa, "External Debt of Developing Countries: Crisis of Growth," *Economic and Political Weekly*, Vol. 26, No. 8 (February 23, 1991), 433-438. See also Henry F. Jackson, "The African Crisis: Drought and Debt," *Foreign Affairs*, Vol. 93, Issue I (Fall 1984): 1081-1094. For details about the IMF's "seal of approval," see Strange, "Finance, Information and Power," 261, 266.

to reschedule payment with their bilateral and multilateral creditors.[75] The second effect, much more protracted, was the external political implication of debtor countries' inability to repay cumulative loans and interests: the governments of those states became more or less puppets in the game of international politics, as they were dictated to by creditor states and their market institutions. In sum, the debt crisis was one of those enabling conditions for market institutions of advanced economies (and their public international partners) to penetrate, globalize, and politicize the world economy while financializing and marketizing its politics. They did so with varying innovative credit instruments.[76]

This does not mean that a debt obligation (whether public or private, syndicated or bilateral) is bad in itself. Debt can be a useful political instrument because it can help governments, corporations, and even individuals leverage investment and achieve desired objectives. Industrialized countries, for instance, had to borrow in a variety of ways to fight for independence, consolidate political structures, build productive capabilities, and accelerate economic growth and development. This practice dates back to at least the emergence of the states system (see chapter 5). The U.S., for instance, was born in debt, a detailed historical account Robert Wright provides in his *One Nation under Debt*.

Debt in any form only becomes problematic when it is unsustainable—when it bubbles, and when there is chronic balance of payment difficulties. Debt exacerbates

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[75] For details on transnational debt management and failures from the 1980s through the 1990s, see Strange, "The New World of Debt." On the role of the IMF regarding developing countries debt, see Cheryl Payer, *The Debt Trap: The IMF and the Third World* (New York: Monthly Review Press, 1975).

[76] See John Walton and Charles Ragin, "Global and National Sources of Political Protest: Third World Responses to the Debt Crisis," *American Sociological Review*, Vol. 55, No. 6 (December 1990), 876; Strange, "Finance, Information and Power," 261. See also Strange, "The New World of Debt."

economic problems when it is used to window-dress growing deficit accounts.[77] That was exactly the case with independence experimenting states. Many of their accumulated debts were, however, part of the legacy of colonial and neocolonial underdevelopment;[78] others were odious debts, for many of those loans ended up in the private accounts of corrupt leaders.[79] They were never used for their intended purposes.

Because such credit facilities were not properly used, debt rescheduling at full value became a political leverage for creditor countries and their financial institutions to reorganize Third World debtor countries and societies through market-led reforms.[80] The conditionality attached to those reforms and debt repayments were later shaped and coded into the Washington Consensus—a "consensus" not only because political Washington, international financial authorities, credit market entrepreneurs, and their market-scholar clients agreed on reform conditionality, but because the debtor nations had no alternative to the terms upon which the reforms were framed, structured, and implemented.

[77] For details on recent international debts and how they are used to windrow-dress deficits, see Gustavo Piga, quoted in Louise Story, Landon Thomas, Jr., and Nelson D. Schwartz, "Wall St. Helped Greece Debt Fueling Europe's Crisis," *New York Times*, February 14, 2010.

[78] From an African nationalists perspective on finance and neocolonialism, see Kwame Nkrumah, *Neo-Colonialism: The Last Stage of Imperialism* (New York: International Publishers, 1966); Walter Rodney, *How Europe Underdeveloped* Africa, rev. (Washington, D.C.: Howard University Press, 1982).

[79] For a typical odious debt in Africa, see Leonce Ndikumana and James K. Boyce, "Congo's Odious Debt: External Borrowing and Capital Flight in Zaire," *Development and Change*, Vol. 29 (1998).

[80] Jeffrey Sachs, Harry Huizinga, John B. Shoven, "U.S. Commercial Banks and the Developing-Country Debt Crisis," *Brookings Papers on Economic Activity*, Vol. 1987, No. 2 (1987): 555-606; Daniel Marx, Jose Echague, and Guido Sandleris, "Sovereign Debt and the Debt Crisis in Emerging Countries: The Experience of the 1990s," in *Sovereign Debt at the Crossroads: Challenges and Proposals for Resolving the Third World Debt Crisis*, ed. Chris Jochnick and Fraser A. Preston (Oxford: Oxford University Press, 2006); R. T. Naylor, *Hot Money and the Politics of Debt*, with Introduction by Leonard Silk (Montréal/New York and London, 1994).

Conditionality was the way of putting sustained pressure on those debtor countries to, as Dani Rodrik succinctly put it, "stabilize, privatize, and liberalize" their economies.[81]

The Washington Consensus was the ultimate open-ended international economic and financial system U.S. policymakers did not construct in 1944. Instead of an open-ended system, they constructed embedded liberal internationalism, which I argue, was the international version of the domestic gap between American political ideals and political institutions. Embedded liberal internationalism was wrapped in global intergovernmental political and economic institutions while the Washington Consensus was a neoliberal, market-driven system designed by U.S. political establishment and Washington economic institutions. As noted in the Chapter 2, the Washington Consensus was made up of key institutions of U.S. and Washington-based public and private international economic institutions. It is for this reason Stiglitz calls it globalization of American capitalism.[82] Strange made the connection between political Washington and globalization clear:

> One of the first and most important—and deducible more by inference than by reference to any specific act or document—was the decision to liberalize international capital movements by putting pressure on America's allies and dependents to make their currencies freely convertible, to lift exchange controls as soon as possible and to allow free entry of foreign investors. This pressure was exercised generally on the Europeans through the IMF, through the OECD, and also in bilateral relations, as with Japan.[83]

This excerpt corroborates Huntington's assertions regarding U.S. transnationalism in the form of globalization, privatization, liberalization, and deregulation of trade barriers.

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[81] Dani Rodrik, "Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's 'Economic Growth in the 1990s: Learning from a Decade of Reform,'" *Journal of Economic Literature*, Vol. 44, No. 4 (December, 2006): 973-987.

[82] Stiglitz, *Globalization and its Discontents*, 2003. See also Joseph E. Stiglitz, "Capital Market Liberalization, Globalization, and the IMF," *Oxford Review of Economic Policy*, Vol. 20, No. 1 (2004): 57-71.

[83] Strange, "Finance, Information and Power," 264.

By designing markets as countervailing moral ballast to internal political power, U.S. policymakers were able to generate the needed domestic political support for the outward projection of national power through the medium of markets and corporations. As Strange pointed out, the projection of U.S. market power was enforced generally by exerting pressure on both dependent and allied countries through multilateral institutions. In effect, the rest of the world went the way the U.S. went, with its inherent "power paradox" at work in the international system. This time, however, the paradox was not so much the gap between political thought and political practice, as it was more of a gap between political power and global markets as collective force for good. With that gap, American presence was almost everywhere, but American rule was almost nowhere.[84] The existence of this gap—the gap between American global presence through market forces and the invisible American rule via liberal democratic governance—made the tension framework pervasive and hegemonic.

The following section examines in greater detail domestic and international factors that made the tension hypothesis ubiquitous. They include the gaps between political ideals and global market power, a shift from state-centered structure of governance to neoliberal market governance, the role of intellectuals, and last but not least, the power and application of the language of political economy.

10. THE DOMINANCE OF THE TENSION FRAMEWORK

I. The Gap between Political Ideals and Market Power

[84] This line of thought reminds us of St. Augustine's description of the "nature of God as a circle whose centre is everywhere, and its circumference nowhere." See this description in Ralph Waldo Emerson, *Essays, First Series* (BiblioBazaar, 1841/2008), 170.

As already noted, one of the factors that made the tension framework dominant was the power paradox in the horizontal global arena—the gap between liberal democratic ideals and global market power. The architects of U.S. power ingeniously created a global force that could be felt but not seen: an "illusory appearance" of markets as virtuous entities. This illusion was truly a paradox prepared by practitioners of political idealism for practitioners of market realism to obscure unfettered political power. With the site of effective power concealed in market institutions, the processes of economic liberalization and privatization were enhanced with political abstractions. The abstractions created the desired opacity for market-based global politics to thrive across so-called the "sovereign" political realms. The tension framework and its rational market theory were then framed, structured, and driven into the collective consciousness as inalienable reality.[85] An irrefutable reality is without an alternative. This habit of mind—the lack of alternative as well as contradictions embedded in the non-determinate site of power—made the tension paradigm truly hegemonic.

II. From Statist Structures to Neoliberal Global Market Governance

With the tension framework established as an incontestable reality, the traditional concept of governance was moved from state-based hierarchical organization to multilayered market-oriented structures which are public and private, national and international, global and regional, intergovernmental and non-governmental, syndicated and multilateral. They consist of important levers of economic policy and financial power on the global stage. They include the World Bank, IMF, World Trade Organization, global insurance firms, transnational corporations, multinational companies, global consulting and accounting

[85] Underhill, *States, Markets and Governance*, 2001, 9.

firms, and the group of industrialized economies (G-7 and G-8).[86] Not only did they promote market rationality and efficiency, they designed and imposed market-friendly standards primarily through multilateral regimes and bilateral arrangements. These institutions derive their influence and legitimacy from specialized knowledge/expert services, performance authority, issue-specific authority, and reputational track records.[87] These sources of influence make their decisions and actions authoritative and compelling.

The paradox of the logic of neoliberal market-based governance is that markets can only exist and function under "certain political, legal, and institutional conditions that must be actively constructed by government."[88] In view of this paradox, and with the prevailing winds of market power blowing forcefully across 'sovereign' territorial realms, political actors—willingly and in most cases unwillingly—transformed the Keynesian welfare state from its development orientated character into finance-driven Competition State.[89] By its nature and structure, the Competition State is a market institution by proxy because it is the strategic promoter and enforcer of market-based rules and

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[86] Robert O'Brien and Marc Williams, *Global Political Economy: Evolution and Dynamics* (London: Pelgrave, 2004), 3; Robert O'Brien, Anne Marie Goetz, Jan Aart Scholte, and Marc Williams, *Contesting Global Governance: Multilateral Economic Institutions and Global Social Movements* (Cambridge: Cambridge University Press, 2000); Stephen J. Kobrin, "Economic Governance in an Electronically Networked Global Economy," in *The Emergence of Private Authority in Global Governance*, ed. Rodney Bruce Hall and Thomas J. Biersteker (Cambridge: Cambridge University Press, 2002): 43-75; Peck and Tickell, *Neoliberalizing Space*, 391. The "seal of approval" made the IMF the most dominant international economic institution within the tension framework. For details on the role of this institution, see Stiglitz, "Capital Market Liberalization, Globalization, and the IMF;" Payer, *The Debt Trap: The IMF and the Third World*.

[87] For details on the crisis of state authority and emergence of "authority structures," see Rosenau, *Distant Proximities*, 282-292.

[88] Quoted in Tore Fougner, "Neoliberal Governance of States: The Role of Competitiveness Indexing and County Benchmarking," *Millennium: Journal of International Studies* Vol. 37 No. 2 (2008), 308.

[89] Cerny, "Power, Markets and Accountability," 24-48; Cerny, "Paradoxes of the Competition State." See also Louis W. Pauly, "Global Finance, Political Authority, and the Problem of Legitimation," in *The Emergence of Private Authority in Global Governance*, ed. Hall and Biersteker, 76-90.

processes. This type of state is embedded in the structures of market forces, with market forces embedded in its political structures. It is the primary advocate and implementer of liberalization of trade, privatization of public assets and services, and competitive deregulation of national economic standards. In other words, the Competition State was short-circuited and enmeshed in market-led global governance structures and processes of resource allocation, production, and consumption. In effect, the industrial welfare state lost its established "capacity to evoke habitual compliance," thus, making the primary responsibility of the Competition State a complete paradox in the sense that it promotes neoliberal market rationality over conventional political rationality.[90]

In sum, the transformation of statist governance into market-based governance made the tension framework with its handmaiden rational market theory dominant. It made it so because there was virtually no alternate conceptual or empirical model. This monumental dispersal of state authority to decentralized market institutions meant that power existed in no meaningful, measurable sense. And governance was fragmented, heterogeneous, and networked. This networked system was promoted by "self-interested capitalists" as well as state bureaucrats and regulators. States promoted the "politics of regulatory change"[91] because issues of state-market relations were framed principally in *economic* rather than political terms. To paraphrase Cordell Hull, the 47th U.S. Secretary of State (1933-1944), the political line-up truly followed the economic/financial line-up.

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[90] See, for instance, Nikolas Rose and Peter Miller, "Political Power beyond the State: Problematics of Government," *The British Journal of Sociology*, Vol. 43, No. 2 (June 1992): 173-205; Wendy Larner and William Walters, "The Political Rationality of 'New Regionalism': Toward a Genealogy of the Region," *Theory and Society*, Vol. 31, No. 3 (June 2002): 391-432. On the welfare state's loss of habitual compliance, see Rosenau, *Distant Proximities*, 282.

[91] See Giselle Datz, "Government as Market Players: State Innovation in the Global Economy," *Journal of International Affairs*, Vol. 62, No. 1 (Fall/Winter 2008): 35-49; Cerny, *Rethinking World Politics*, 21.

Consequently, almost every issue was perceived through economic lenses and analyzed through economic modeling (economic formulae, quantification, and projections) to generalize solutions. The predominance of economic theory and quantification was, indeed, evident in transnationalized method of production, distribution, and consumption. The power transnationalized economic agents exerted on states to make market-driven democracy safe for multinational corporations and international financial institutions enhanced the reputation of Economics as a discipline. The fashionable belief was that markets were truly the embodiments of human relations and, therefore, the source of freedom and efficiency.

The overall consequence of this transformation is that the Competition State was continuously reconstituted and acted upon as a 'competitive market subject' that designs, promotes, guarantees, and enforces market-oriented policies and processes.[92] The framing of all aspects of life (living and non-living) in economic terms and economic lenses, made the market-driven governance omnipotent, omniscient, and omnipresent.[93] The financial press, business people, and "globalist groupings" (Rosenau) hailed the global mode of production, distribution and consumption as the ultimate stage in human development. No scholarly work epitomizes this claim better in the 1990s than Francis Fukuyama's eschatological account of the death of socialist/communist ideology.[94]

It must be pointed out that the ideas of freedom, efficiency, and equality that markets supposedly embody, are powerful ideals around which citizens can be rallied in

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[92] Fougner, "Neoliberal Governance of States," 314-20; Cerny, "Embedding Neoliberalism," 1.

[93] See Cox, "The Market as God: Living in the New Dispensation."

[94] Francis Fukuyama, *The End of History and the Last Man* (New York: Avon Books, Inc., 1992). Fukuyama's "last man" was the figurative liberal democratic market-based order of society, the allegoric representation of the triumph of liberal capitalism over socialism.

market-based democracies. But these ideals are not value-free; they belong in the realm of theorists and intellectuals. To that end, neoliberal theoreticians and intellectuals played major roles in making the tension framework dominant and ever-present.

III. The Role of Theorists and Academic Institutions

The role/impact of scholars, academic institutions, and research foundations in designing, disseminating, and popularizing theories cannot be underestimated. John M. Keynes was absolutely right when he argued that "Practical men, who believe themselves to be quite exempt from any intellectual influences" are unconscious captives of paradigms created by "some academic scribbler of a few years back."[95] In other words, intellectuals are the vanguards of ideology and social knowledge; they frame and shape perception of reality. Robert Green's assertion that "[t]he people who are best at appealing to people's minds are … intellectuals, and those of a more poetic nature," upholds Keynes claim about the power and influence of intellectuals in shaping social and political consciousness.[96]

That is to stress that the tension framework and the efficient market theory could not have been hegemonic without mainstream IPE "epistemic communities" and their neoliberal academic institutions and policy centers, many of which acted as clients of market institutions and practitioners. Through their analyses and interpretations, they helped to impose the orthodoxy of market rationality as a "common sense." In fact, extensive literature on the role of intellectuals and policy institutes in designing the

[95] John Maynard Keynes, *The General Theory of Employment Interest and Money* (New York: Classic Books, 1936/2009), 328.

[96] Green, *The 48 Laws of Power*, 374. Awareness of the power and influence of intellectuals in shaping public consciousness is not new, for as detailed in Kautilya's *Arthaśāstra*, the fourth century B.C. Sanskrit work on political economy, for instance, "An arrow, discharged by an archer, may kill one person or may not kill (even one); but *intellect* operated by a wise man would kill even children in the womb" (emphasis added). See Kautilya, *The Arthaśāstra*, 2nd ed., trans. R. P. Kangle, Part II, repr. (Delhi: Motilal Banardisass, 1992), book 10, chapter 6, line 51, page 453; hereafter, 10.6.51:453.

philosophical foundations of neoliberalism and the efficient market hypothesis exists.[97] As Jan Aart Scholte pointed out, the "rationalist constructions of knowledge … in the form of modern economic science," dominated the halls of academia.[98] In essence, the teachings of market theoreticians (with emphasis on econometrics, mathematical jargons, elegant symbols and formal economic analysis) are interesting even when they are false, Dierdre N. McCloskey argues.[99] Their focus on rationality, Pareto optimal efficiency, quantitative modeling, mathematical game theory, public choice theory, and claims to sociology of knowledge made state-market tension hegemonic. In effect, they shaped market-driven knowledge, production, consumption, and consciousness.

As a result of these transformations, the discipline of economics (with emphasis on individual choices, freedom, rationality, and property rights) came to serve as the intellectual foundation for market governance. This is evident in the fact that until the financial crisis occurred, Economics was largely accepted as the only social science discipline closer to the natural sciences. But this image of the discipline has, again, come

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[97] The meaning ascribed to term "neoliberalism" by its inventor, Alexander Rüstow, is the exact opposite of what is ascribed to it currently. Instead of a state operating below markets, Rüstow advocated for a strong state above the economy and above interest groups. See Oliver Marc Hartwich, "Neoliberalism: The Genesis of a Political Swearword," The Center for Independent Studies (CIS) Occasional Paper 114, May 2009, available at http://www.cis.org.au/temp/op114_neoliberalism.pdf (accessed December 23, 2009). See also Cerny, "Embedding Neoliberalism;" Harvey, *A Brief History of Neoliberalism*, 3.

[98] Jan Aart Scholte, *The Sources of Neoliberal Globalization*, Program Paper No. 8 (Geneva: United Nations Research Institute for Social Development, 2005), 16. George Soros expressed a similar view in a follow-up interview on his "Theory of Reflexivity" Lectures at Central European University in Budapest, in October, 2009, when he stated that "ideologists in the free markets are still in command" in major academic institutions. See "Transcript: George Soros on the Institute of New Economic Thinking," *Financial Times*, October 27, 2009. For a detailed analysis of the role of academics in codifying the rational market theory, see also Fox, *The Myth of Market Rationality*.

[99] Dierdre N. McCloskey, *Knowledge and Persuasion in Economics* (Cambridge: Cambridge University, 1994), xi.

under criticism from economists and non-economics alike.[100] Albert Einstein once noted that economists strive like physical scientists to "discover laws of general acceptability," although in reality methodological distinction exist between their disciplinary spheres.[101] In spite of such methodological peculiarities, neoliberal economists, by and large, *claim* to have "discovered" the law of general acceptability in the form of efficient rational market hypothesis—a claim that had worldwide implications for society and ecology the itself. But as the global financial crisis quite reveals, markets are not rational after all.[102]

IV. Language, Concepts, and Politics

The role of language and concepts in the discourse of political economy and the broader social sciences cannot be overemphasized. Concepts that are deeply rooted in familiar terminologies make ideas they seek to explain dominant. Concepts make perceptions ubiquitous because the conceptual world, language usage, social life, and political practice are inextricably intertwined.[103] In other words, the 'making of the world and meaning making of the world' are linguistically inseparable. As indicated earlier, the theoretical framework for market-based democracies was rooted in social construction of knowledge and relations of power. It is in this context that the role of language and the power of words in making the rational market theory hegemonic cannot be glossed over.

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[100] See for instance, Paul Krugman, "How Did Economists Get It So Wrong?" *New York Times*, September 2, 2009.

[101] Albert Einstein, "Why Socialism," *Monthly Review* (May 1949), 9.

[102] See Fox, *The Myth of the Rational Market*; Joe Nocera, "Poking Holes in a Theory on Markets," *New York Times*, June 5, 2009.

[103] Pierre Bourdieu, *Language and Symbolic Power*, edited with Introduced by John B. Thompson, translated by Gino Raymond and Matthew Adamson (Cambridge: Harvard University Press, 1991). As Noam Chomsky observed in an interview with Deborah Solomon, language "is a weapon of politicians" as it is "a weapon in as much of human affairs." For details, see Debora Solomon, "The Way We Live Now: 11 - 2 – 2003: Questions for Noam Chomsky: The Professorial Provocateur," *New York Times*, November 2, 2003.

As an analyst rightly put it, if indeed, the sun obeys the syntax of poet Khlebnikov, then one is not wrong to say that the public abide by theories and interpretations of neoliberal political economists. If the "limits of one's language mark the limit of one's world,"[104] then language defines/obscures reality and can make deceptive manifestation virtuous.

In that sense, the language of orthodox political economy creates a façade that makes neoliberal markets appear more virtuous. The application of market-oriented poetic vocabulary by charismatic politicians helped to make the tension framework omnipresent. For instance, President Regan's famous lines: "Government is not the solution to our problem. Government is the problem,"[105] and Prime Minister Thatcher's "There is no alternative. You can't buck the market,"[106] helped to solidify the tension framework and the efficient market theory into hegemonic, all-encompassing reality. Such syntactic and artistic display of morphemes projected the infallible qualities of markets, and thus, left them with no empirical defense.

Quite related to language is the fact that markets have been *anthropomorphized*. Attributing the defining human virtue—rationality—to market institutions made them omniscient. This fundamental quality embedded the efficient market hypothesis, as it imputed to firms the ability to determine human needs and feelings. Phrases that infer market rationality include 'market discipline;' market 'reaction' to political decisions; markets 'evading/escaping regulation;' market 'behavior,' markets 'interpreting data,' market 'apprehension,' and markets being 'jubilant.' These anthropomorphisms make

[104] Terence Ball, James Farr and Russell L. Hanson, "Editor's Introduction," in *Political Innovation and Conceptual Change*, ed. Terence Ball, James Farr and Russell L. Hanson (Cambridge: Cambridge University Press), 2. On the syntax of poet Khlebnikov, see a citation in Keith Jenkins, *Re-Thinking History* (London and New York: Routledge, 1992), 12.

[105] Auerbach, "Is Government the Problem or Solution?"

[106] Peck and Tickell, *Neolibralizing Space*, 381.

market institutions and actors seem not only rational but infallible. The Reaganite and the Thatcherite assertions above are affirmation of market infallibility. The *infallible* concept made the efficient market theory acceptable as a norm of life. In other words, the rational and infallible attributes made the state-market tension truly an epic "tug-of-war." And the epic struggle was consistently invoked to justify decisions and non-decisions in the political economy.

Specifically, the tension framework was embedded in the concept of "markets" without the signifier "finance," even though finance is at the core of the market economy. There is an historical reason for this anomaly, for as Murray Polakoff and his co-authors pointed out, "Deeply embedded in the American culture," they write, "is an antagonism toward the pillars of finance—the stock exchange and investment and commercial banking—all, in other words, that has often been denounced under the generic term 'Wall Street.'"[107] This kind of distrust is a recurrent theme in U.S. history. It was a rallying theme for populist, progressive opposition to economic centralization in the Gilded Age. In a political campaign speech around 1890s, Mary E. Lease, a Populist Party activist and lawyer declared that: "Wall Street owns the country. It is no longer a government of the people, by the people and for the people but a government of Wall Street, by Wall Street, and for Wall Street."[108] The point here is that historical lessons regarding populist hostility towards Wall Street clearly suggests that it would have been a political disaster for U.S. policymakers to construct a market framework with "finance" as its signifier.

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[107] Polakoff et el., *Financial Institutions and Markets*, 62. Of course, tension between Wall Street and Main Street is still with us, as the ongoing policy debate on financial regulation shows. For a relatively historical analysis of this tension, see Ripley, *Main Street and Wall Street*. Of course, one cannot lose sight of the ongoing demonstration against Wall Street dubbed, "Occupy Wall Street." See N. R. Kleinfield and Cara Buckley, "Wall Street Occupiers, Protesting Till Whenever," *New York Times*, September 30, 2011.

[108] Quoted in Edwards, *The Evolution of Finance Capitalism*, 190.

That could provide a new tool for old "banking populism,"[109] a situation that would undermine domestic political support for effective execution of market ideology abroad. As democratic politicians always need public support and legitimacy for their policies, it was reasonable, therefore, to embed finance in generic "market" terms. That concealed the site of power; effective power, indeed, is embedded power.

V. Framing the Conceptual Structure

Skillfully framing an intellectual issue sets the agenda to one's advantage. That was exactly the case with regard to the tension framework. In that sense, Strange observes:

> [B]y concentrating for the sake of internal logical consistency on the efficacy of the [market] system in allocating resources, [market theorists] have encouraged the idea that economic systems are judged by their efficiency, by their capacity to produce, to maximize output and the satisfaction of effective demands.[110]

In other words, by emphasizing the effectiveness of the market system in resource allocation and at the same time de-emphasizing the role of the state, proponents of the tension framework successfully constructed the rational market hypothesis without any alternative model. In doing so, the global elites of managerial class, their intellectual clients and neoliberal political authorities and the conglomerate power of the market media made the tension framework virtually the only game in town. Even where the global game was "degenerating into an instrument of oppression" (as has been the case historically), market-friendly analysts and theoreticians responded by emphasizing that

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[109] Philip G. Cerny, "Money and Power: The American Financial System from Free Banking to Global Competition," in Grahame Thompson, ed., *Markets: The United States in the Twentieth Century* (Milton Keynes, U.K.: Hodder & Soughton, 1994), 177.

[110] Strange, "The Study of Transnational Relations," 342.

the game might not be the best, the rules and standards might not be fair enough, and the playing field might be rough, but it is the only "great game"[111] available in the world.

In fact, the role of the financial press in embedding the state-market dynamics cannot be overestimated. The function of a skeptical media, the fourth estate of a liberal democratic state, is to expose power. As Huntington argues, "the dismantling of power requires the exposure of power."[112] But this was not the case in the competitive, finance-driven state-market game. The press and credit rating agencies were rather in close relations with market institutions/actors in promoting the tension framework. In so doing, they made the paradigms dominant in at least three ways.

First, they created a sharp dichotomy between state and market, with broadcast news and newspapers having separate sections on politics and business as if such divisions are distinct and do not affect one another.[113] These kinds of divisions are not bad in themselves because social reality, like physical reality, can best be conceptualized when its constituent parts are isolated and the relations between them are analyzed. The problem, however, is that such divisions represent separation and distinction between states and markets, as they portray economics and politics in antipodean terms.

Second, the media also popularized the anthropocentric attributes of markets to the extent that the social structure accepted them without really attempting to identify any inconsistencies in them. In other words, the media sustained the creative conflict and the rational market theory to a degree where the public hardly ever questioned the picture-

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[111] For details about this game, see Gordon, *The Great Game: The Emergence of Wall Street as a World Power*. See the quote beginning with "degenerating..." in Ripley, *Main Street and Wall Street*, v.

[112] Huntington, *American Politics*, 99.

[113] Underhill, *States, Markets and Governance*, 7-8.

perfect image of market rationality. Views and opinions that go against the accepted economic thinking were discredited and marginalized. As it were, human progress and development came to be based on the daily fluctuations of market indices.

The third reason focuses on the responsibility of market/credit rating agencies. Regulatory institutions depend on the services of rating agencies because the latter are registered as such.[114] Instead of delivering on their statutory function by reporting and actually exposing inefficiencies of market institutions and grading them accordingly, the rating agencies projected the infallibility of those institutions by effectively hiding their incompetence. For instance, until Lehman Brothers exploded in the open, it remained an AAA rated company. That is to say the rating agencies supported the tension framework by projecting the direction that market-driven institutions dictated. They magnified the achievements of market actors while exaggerating the failures of governments.[115] It is understandable why they support the tension framework: they are regarded very often as part of the money making process. These financial conflicts of interest explain why political actors are reshaping statutory roles of rating agencies.[116]

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[114] U.S. Securities and Exchange Commission, "Credit Rating Agencies—NRSROs," modified 09/25/2008, available from http://www.sec.gov/answers/nrsro.htm (accessed April 23, 2010).

[115] In fact, the rating agencies continue to exaggerate government failures under circumstances that other international financial institutions deem "questionable" and controversial. See, Moses Mozart Dzawu, "S&P's Ghana Sovereign Debt Downgrade to B was 'Questionable,' IMF Says," *Bloomberg News*, August 31, 2010; Moses Mozart Dzawu and Jason McLure, "Ghana Sovereign Rating Reduced by S&P on Deficit, Oil Regulation Concerns," *Bloomberg News*, August 27, 2010; William Wallis, "Ghana: Downgrade Raises Eyebrows," *Financial Times*, Sept. 1, 2010; "Duffour Dares S&P: Calls for Review Meeting," *Daily Graphic* (Ghana), September 6, 2010.

[116] It became an open knowledge, following the 2008 credit crisis, that the revenue of rating agencies depended on market institutions whose instruments they are statutorily required to rate. See Gretchen Morgenson and Louise Story, "Rating Agency Data Aided Wall Street in Deal," *New York Times*, April 23, 2010; Sewell Chan, "Documents Show Internal Qualms at Rating Agencies," *New York Times*, April 22, 2010; Sewell Chan, "Former Employees Criticize Culture of Rating Firms," *New York Times*, April 23, 2010; Paul Krugman, "Berating the Raters," *York Times*, April 25, 2010; Aaron Lucchetti, Serena Ng and Greg Hitt, "Rating Agencies Face Curbs," *The Wall Street Journal*, May 12, 2010.

10. POLITICAL SUCCESS OF THE TENSION FRAMEWORK

In the short-run, the tension framework with its handmaiden rational market hypothesis was self-reinforcing in terms of political organization. It provided counterweight against society by balancing efficient market theory against societal-institutional values. This balancing meant that neoliberal political authorities could embed policies and programs within the rational market orthodoxy. This arrangement made governance of social relations apparently easy because when citizens blamed their inefficient state apparatuses, governments, in turn, transferred the blame onto markets. This kind of governance was effective in the short-term. In the long run, the transfer of blame did not work, as the center of the tension structure began to fall apart. Precipitous collapse abounds in independence experimenting states where IMF conditionality compelled state actors to commodify public goods and social services on massive scales.[117]

There is little doubt that ideology provided the overarching framework for the neoliberal political project. Organizing power relations as a "dog-eat-dog" phenomenon between states and markets apparently made management of power relations easy. The framework made governance complex and dense such that political variables were generally unattractive to the so-called rational voter,[118] many of whom are antipathetic to politics. In that sense, voters follow political entrepreneurs who seem to care for them, and who appear to explain complex issues to them. They vote for authorities who seek to

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[117] James Ferguson, *Global Shadows: Africa in the Neoliberal World Order* (Durham, NC: Duke University Press, 2001).

[118] See Caplan, *The Myth of the Rational Voter*; Judith Warner, "The Irrational Voter" (in 'Opinionater,' Exclusive Online Commentary), *New York Times*, February 1, 2007.

justify why the mass publics should be cared for, and the masses in turn accord political actors extra rationality even though they (the mass public) found the issues unattractive.

11. WEAKNESSES OF THE TENSION FRAMEWORK

The tension framework, which somehow suggests a law of general applicability, is fundamentally flawed. Discovering a law of general acceptability in social sciences is difficult because social phenomena are often affected by factors that are hard to evaluate independently.[119] The complexities of human experience go beyond the boundaries of economics alone. Moreover, a market system cannot serve as the primary guide for human behaviour, not even the physical sciences can do that. As Einstein rightly noted, when it is a question of human problems the natural sciences cannot create the "social-ethical-ends."[120] That is to say neither the physical sciences not the market system can create social-ethical-ends. This point is central to the study of finance and political economy. Finance is not an exact science, and political economy has no general laws applicable to every society under all circumstances. The best political economy, as Aldrich observed, is one that responds to the needs and requirements of its people.

The fundamental flaw of the tension framework and its theory is their ascription of rationality to market forces. Analysts have come to acknowledge the said ascription as a myth. The fact is that even human beings are not that rational; they are deficient in rationality—their "basic virtue."[121] Greenspan, the distinguished advocate for rational markets has acknowledged his personal misunderstanding of this grand orthodoxy.

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[119] Einstein, "Why Socialism?" 9.

[120] See Einstein, "Why Socialism?" 9, 10.

[121] On rationality—human's basic virtue—see Ayn Rand, *The Virtue of Selfishness: A New Concept of Egoism*, with Additional Articles by Nathaniel Branden (New York: Signet, 1961), 22. On

12. CONCLUSION

I have illustrated through historical review and contemporary analysis that the state—until recently the main object of study in world politics and IR—is a political construct, rather than a natural entity. Being a political project, the state is constructed by bringing classes of people and geography to form the nation-state.[122] This involves some form of indoctrination into accepting of rules, ideas, power structures and policy decisions that are imputed to the state. Citizens, therefore, are not 'born;' they are *formed* through political socialization. Ideology, which is grounded primarily in conceptual and theoretical frameworks, is at the core of *forming* citizens. The theoretical framework within which the early forms of state building consolidated was the Janus-like structure of 'inside/outside' realms. The notion of justice, equal representation and fairness take place 'inside' while tension, force, competition, and war characterize ' outside' relations.

The review highlights the historical development of the Janus-like tension and details how its totalizing narratives were extrapolated into the study of state-market relations from the 1970s. Because citizens are formed, creative tension between states and markets gained legitimacy through everyday usage of the concept. In so doing, market forces appeared as inevitable entities. Students of IPE generally found this grand political narrative 'natural' and, as such, discussed markets and states as fundamentally distinct entities with different systems of governance. Market is based on *private rights* in private domains and the state is based generally on rights defined and shaped by laws

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market and human irrationality, see Nassim Nicholas Taleb, *Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets*, 2nd edition (New York: Random House, 2005), xiv; Nassim Nicholas Taleb *The Black Swan: The Impact of the Highly Improbable* (New York: Random House, 2007).

[122] Cerny, "The Competition State Today," 6; "Neoliberalisation and Place,"14.

and constitutions. As a result of the division, politics is seen as the management of tension between public and private spheres in domestic realm as in international system.

Although the tension framework was contested over time, it was the global credit crisis and the political reactions to it that actually exposed its flaws. The flaws highlight the framework as an ideological mask for the claim that rational markets are ultimately efficient than states. The flaws have shown how capitalist states to co-opted developing economies as active competitors in the global politics of liberalization, privatization, and deregulation of trade standards and processes when, in fact, such developments only enhanced investments opportunities for private institutions of industrialized nations. This exposure means that a new mode of thinking about the nature of IPE is needed. That new conceptual mode is what the marketplace framework is about.

CHAPTER 4

CONCEPTUAL PREMISE OF THE MARKETPLACE FRAMEWORK

> We have entirely lost the idea that any undertaking likely to pay, and seen to be likely can perish for want of money [finance, broadly defined].
>
> –Walter Bagehot[1]

> The power to create credit implies the power to allow or to deny other people the possibility of spending today and paying back tomorrow, the power to let them exercise purchasing power and thus influence markets for production, and also the power to manage or mismanage the currency in which credit is denominated.
>
> –Susan Strange[2]

> Credit furnishes a vital element in all healthy economic life. Credit is based upon confidence; and confidence in a monetary system rests upon belief in the strength, stability, and efficiency of financial institutions. To secure an organization of capital and credit by which confidence can be firmly established, and credit maintained under all circumstances and conditions, is the task committed to the National Monetary Commission.
>
> –Nelson W. Aldrich[3]

1. INTRODUCTION

These quotations shed light on the fundamental element of the marketplace framework. The first one illuminates the significance of finance in political economy. The second one emphasizes the structural and relational power of finance—that is, "power as the capacity to affect … the very essence of social relations."[4] The last one highlights the

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[1] Walter Bagehot was a nineteenth century British banker and editor-in-chief of *The Economist*. His statement is quoted in Ross Levine, "Financial Development and Economic Growth: Views and Agenda," *Journal of Economic Literature*, Vol. 35, No. 2 (June 1997), 699.

[2] Strange, *States and Markets*, 88.

[3] See *An Address by Senator Nelson W. Aldrich*, 3; Nelson W. Aldrich, "Europe and Central Banks," *New York Times*, January 9, 1910.

[4] See Schutz, *Markets and Power*, 4.

pragmatic regulatory condition within which finance is securely organized. The "key question of finance," Germain contends, "is gaining access to credit."[5] And access to credit, as the second excerpt shows, is a pragmatic regulatory process that is fused with power and influence, confidence and trust, authority and control. From this perspective that the chapter elaborates on the postulating and unifying principles of finance, the component elements, and the major sites of regulatory coordination that together make up the marketplace framework. Understanding the symbiotic and circulatory effects of fixing potential values of finance and the necessary conditions under which such is organized is critical to comprehending the principles of the marketplace framework.

2. THE ROLE OF FINANCE IN THE MARKETPLACE FRAMEWORK

I begin analysis of the marketplace framework with a claim: finance and the Weberian "state"[6]—defined in terms of its *means* rather than its *end*—are reflections of politics and should, therefore, be examined as cognate entities. Finance is the "infrastructure" of the superstructure state and the system of states,[7] the "central stomach" from which "all other

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[5] Germain, *The International Organization of Credit*, 17.

[6] The Weberian inference to finance as *the means* that makes "force" specific to the state has an ancient reference in Kautilīya's *Arthaśāstra*—the ancient Indian political treatise—whose radical realism surpasses Machiavellianism, according to Weber. In it is declared: "the source of the livelihood of men is wealth, in other words, the earth inhabited by men [but] the science which is the *means* of the attainment and protection of that earth is the Science of Politics" (emphasis added). This excerpt relates to Weber's definition of the *state* in that politics *is* the science of acquiring and maintaining the earth, but the *means* of administering the political economy is finance. For details, see Weber, "Politics as Vocation," 1, 16-17, 25; Kautilya, *The Arthaśāstra*, 15.1.1:512; Roger Boesche, "Kautilya's *Arthaśāstra* on War and Diplomacy in Ancient India," *The Journal of Military History*, LXVII (January 2003), 15.

7 See Cerny, "The Infrastructure of Infrastructure? Toward Embedded Financial Orthodoxy in International Political Economy," 223-49; Cerny, "The Political Economy of International Finance," 10; Cerny, *Rethinking World Politics*, 246. A similar thought is the central thesis of Charles Tilly's *Coercion, Capital, and European States, AD 990-1990* (Cambridge, MA: Basil Blackwell, 1990).

organs" of the state and the states system take their "tone"[8] in reinforcing the structures of the political economy. Finance is so described because it is the tectonic structure upon which the constitutive elements of the state are formed. As a structurally 'designed' and hierarchically organized political entity, the state cannot exist or function effectively without the chemical power of finance. Neither can the interstate system—organized on Janus-like principles—be reasonably governed without the relational power of finance. Because of this critical role, whenever a financial system is threatened with disruption, all other coalescing principles (economic, monetary, social, moral, legal values) of the political economy are susceptible to dissolution.[9]

Considered from mechanical and industrial points of view, finance is to the state and the interstate system what energy is to industry. It is the dynamic chemical that lubricates the structural components (the pistons, turbines, pumps, bearings, and cams) of the political economy. Finance is the source of the state's structural and transformative power, the conveyor belt linking innovative ventures with production and exchange processes across national boundaries. Although innovation creates the new values that are essential for economic growth, capability building and development of exchange relations, it is finance that integrates, intertwines, and reinforces innovative practices and

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[8] Gladstone was the nineteenth century British statesman variously described as "the greatest Liberal," the "greatest financier," "the greatest Chancellor of all times" and "the oldest British Prime Minister" ever appointed. For the quote, see Anthony Jay, ed., *Oxford Dictionary of Political Quotations*, 2nd ed. (Oxford and New York: Oxford University Press, 2001), 147.

[9] A financial system may be administered in three interrelated ways: 1.) it may be centrally organized by a government; 2.) it may be based primarily on capital market activities, and 3.) it may be dominated by credit-based financial institutions such as stock exchanges, insurance firms, and banks. The optimal system in our globalizing world economy is one that integrates the basic structures of the three classifications. For details, see Zysman, *Governments, Markets, and Growth*, 55, 69; Hazel J. Johnson, *Global Financial Institutions and Markets* (Malden, MA: Blackwell Publishers, 2000), 3-4; Germain, *International Organization of Credit*, 12; Stiglitz, "The Role of the State in Financial Markets," 23.

ideas. It does so through the combination of such instruments and processes as bank notes and checks, credit and debit card transactions, determination of currency values, securitization of debt, credit derivatives and regulatory enforcement of contractual rights and obligations. Macroeconomic policy objectives of coordinating aggregate investment with aggregate consumption cannot be realized within and across political realms without well functioning financial systems. No extensive production networks and exchange practices characteristic of the modern world economy are undertaken without finance. In sum, finance is the *means* to all other *means*—the fulcrum—of society-state relations.

Not only is finance the nexus of production-consumption configuration; it is the invisible bond that enables structured and integrated fields of action, broadly construed. As Cerny argues, finance dematerializes all relationships because it is the most integrated playing field within and across political systems. It is because of this attribute Karl Marx argues that finance (or capital/money, as Marx called it) is the link between object and need, the imperceptible tie between life and the means of life.[10] Fundamentally, finance is the "bond of all bonds" in the political economy—the bond between individuals and households, firms and labor, governments and societies, and between society and nature.

Of course, analyses and interpretations of the nature of finance in state-society relations are not new. Shakespeare illustrates it by way of the power of money, an analysis Marx forcefully rearticulated as follows:

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[10] See Karl Marx, *Capital: A Critique of Political Economy*, ed., Frederick Engels, trans. from the 3rd German edition by Samuel Moore and Edward Aveling, rev. according to the 4th German edition by Ernest Untermann (New York: The Modern Library, 1906), 171, henceforth *Capital*. On finance's ability to dematerialize all relationships, see Cerny, "The Political Economy of International Finance," 5, 10. It does so because the structural arrangement by which funds flow through the political economy have fundamental effects on society and nature.

> That which is for me through the medium of *money*—that for which I can pay (i.e., which money can buy)—that am I, the possessor of the money. The extent of the power of money is the extent of my power. Money's properties are my properties and essential powers—the properties and powers of its possessor. Thus, what I *am* and *am capable* of is by no means determined by my individuality ….
>
> If *money* is the bond binding me to *human* life, binding society to me, binding me and nature and man, is not money the bond of all *bonds?* Can it not dissolve and bind all ties? Is it not, therefore, the universal *agent of divorce?* It is the true *agent of divorce* as well as the true *binding agent*—the [universal] *galvano-chemical* power of Society (emphasis in original).[11]

As this extract shows, finance is the cementing power that links individuals to society, society to nature, and nature to individuals and the state. It illustrates a first-order-relationship between the structures of finance and organization of political economy.[12] Finance is the catalyst for competence creating, defense spending, entitlement programs, and humanitarian projects that are distinctive of the modern state and states system. For Marx, it is the hen that "lays golden eggs,"[13] and for Adam Smith, the "circulating capital" or the metaphorical "waggon-way through the air" that countries must create in

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[11] Karl Marx, "Economic and Philosophic Manuscript of 1844," in *Classical and Contemporary Sociological Theory: Text and Readings*, ed. Scott Appelrouth and Laura Desfor Edles (Thousand Oaks, CA: Pine Forge Press, 2008), 54.

[12] The first-order relationship between finance and economic development is not a settled proposition among economists. For instance, Joan Robinson argues that finance simply follows where enterprise leads. Robert E. Lucas, Jr., the 1995 Nobel Prize winner in Economics also argues that "the importance of financial matters is very badly over-stressed" in professional and popular economic discussions. Others, including Nouriel Roubini and Xavier Sala-i-Martin, explain why some governments adopt financial repression policies (i.e., restriction on interest rates and anti-usury laws). They do so because they believe the financial sector is the spring board of easy inflationary resources for public budget. They believe such would decrease "transaction costs of converting non-liquid assets into liquid assets," which would, in turn, lead to inflationary finance and reduction in seigniorage. For details, see Levine, "Financial Development and Economic Growth," 688; Robert E. Lucas, Jr., "On the Mechanics of Economic Development," *Journal of Monetary Economics*, Vol. 22, Issue No. 1 (July 1988), 6; Nouriel Roubini and Xavier Sala-i-Martin, "Financial Repression and Economic Growth," *Journal of Development Economics*, Vol. 39, Issue 1 (July, 1992), 8; Nouriel Roubini and Xavier Sala-i-Martin, "A Growth Model of Inflation, Tax Evasion, and Financial Repression," *Journal of Economic Literature*, Vol. 35 (1995).

[13] As Marx observed, because finance is value, "it has acquired the occult quality of being able to add value to itself. It brings forth living offspring." See Marx, *Capital*, 172.

order to raise the output of labor and increase the wealth of nations.[14] In effect, finance as a *circulating system* of capital is what political authorities must organize and maintain under all circumstances in order to increase productivity, deepen exchange relations, and boost the wealth and power of states. It is "the great wheel of circulation" that Smith argues "is altogether different from the goods which are circulated by its means."[15]

In effect, financial systems make large scale processes and complex exchange practices possible. They mobilize structural savings, allocate resources, and provide payment services thereby balancing competing and conflicting interests of economic, social and political groupings.[16] They fund innovative ideas and link exchange of goods and services across organized political systems. They do so by sharing and diversifying risks—processes that make the global economy go round. As Walter Bagehot rightly noted, productive ventures perish for want of finance. In essence, organization of credit and the funding of innovative ideas are possible because of the convertible, recurring, and circulating nature of finance. These qualities allow the creation of credit into mediums of exchange, including bank notes and drafts, bonds and equities, and ubiquitous debit/credit cards—financial instruments that are changeable into consumable and non-consumable goods and services and back into finance, again. The conversion as well as circulating

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[14] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (henceforth, *The Wealth of Nations*), edited, with Introduction, Notes, Marginal Summary, and Enlarged Index by Edwin Cannan (New York: The Modern Library, 1994), 349, 1046.

[15] Finance as a means of circulation is different from *money*, which is a *finite article* of circulating capital. In other words, circulating capital is much more complex than money; the latter is a specific "form" of the former. For details on finance as the "great wheel of circulation," see Smith, *The Wealth of Nations*, 314. For finance being a value that changes, expands, and preserves itself, see Marx, Capital, 172.

[16] The World Bank, *World Development Report 1989: Financial Systems and Development* (Oxford: Oxford University Press, 1989), 25.

process is inexhaustible in terms of inherent potentials. As Marx rightly observes, it is the automatic, spontaneous movement or expansion of finance that adds surplus value.[17]

The circuitous logic of credit is comprehensible when finance is conceptualized and understood, as Strange argues, as "information" or "information capital" (Stiglitz).[18] That kind of conceptualization makes transfer and allocation of resources as well as risks feasible because it not only underscores credit organization and management; it also allows identification and fixation of potential values in tangible and intangible assets.[19] A potential value—the *intrinsic* worth of a resource—differs from a primary value, which has direct utility.[20] The intrinsic value of finance generates added utility and creates what Smith calls "revenue" by "changing masters."[21] When the potential value of a resource is determined, fixed, and allocated into circulating capital, it generates surplus values for further utility in the circuitous process of wealth creation. Understood in this manner, the organization of credit is the ultimate source of economic growth and development. This process, which is *finance* in itself, is symbiotic with advanced liberal politics in the sense that it is the sustaining and unifying principle of the capitalist system, broadly defined.

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[17] In the process of spontaneous expansion, finance throws off "surplus-value from itself." That is to say the value adding process is what finance truly represents. See Marx, *Capital*, 164, 171-172.

[18] Strange, "Finance, Information and Power;" Stiglitz, "The Role of the State in Financial Markets," 24. For a recent journalistic analysis of finance as information, see Claire Cain Miller and Nick Bilton, "Cellphone Payments Offer Alternative to Cash," *New York Times*, April 28, 2010.

[19] See Stiglitz, "The Role of the State in Financial Markets," 24-25. See also Strange, "Finance, Information and Power;'" Gelpern, "Domestic Debt," 152.

[20] The direct utility of a resource affords no added revenue; it is a value in, and of itself. The potential value of a resource is the extra, convertible worth derived from the primary value; it is not the same as the resource itself. Put differently, the *essence* of an asset or a liability subsists in its perceptive values; it does not exist in the natural form of the resource, however important that might be.

[21] Smith, *The Wealth of Nations*, 305-306. See also Hernando de Soto, *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else* (New York: Basic Books, 2000), 42-45.

Finance, therefore, is a political derivative—the interstitial cell—in the nervous system of states and between states. The political derivation is a complex interactive process in advanced liberal capitalist states. Such is evident in the intersection of their electoral politics and campaign financing—a process that is fused with political auction of policy bidding, policy production, and policy consumption by networks of political units and enterprise groups.[22] That is to say, at the heart of advanced liberal capitalist states is the politics of finance, which means political derivation of finance and financial derivation of politics, are a symbiotic reflection of the nature of such states. Stated in other words, the creation of a strong liberal political society is the indispensable step toward securing robust financial capitalism. Such is a competitively coordinated game organized within acceptable regulatory financial latitude—a game that reflects the increasingly changing contractual world of financial exchanges where "privateness" and "publicness" are needlessly antipodean realms.[23] In effect, the game is founded on the subtle understanding that effective organization of the public sphere requires efficient management of the private realm, and vice versa. That requires pragmatic regulatory coordination to create dynamic sociopolitical equilibrium while guaranteeing allocative and distributive efficiency of financial market institutions and agencies.

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[22] For details about the process of extracting gains through politicking, see John Heilemman, "Obama is from Mars, Wall Street is from Venus: Psychoanalyzing One of America's Most Dysfunctional Relationships," *New York Magazine*, May 22, 2010; Robert Reich, "Time to Take Wall Street out of Washington," *Financial Times*, April 26, 2010. Similar ideas are discussed in Sam Peltzman, "Toward a More General Theory of Regulation," *The Journal of Law and Economics*, Vol. 19, No. 2 (August 1976), 240; Cerny, *Rethinking World Politics*, 39.

[23] This game reflects the broader themes, conclusions, and symbolisms in such works as Gelpern and Gulati's "Public Symbol in Private Contract" and Jeff Weintraub and Krishan Kumar's edited *Public and Private in Thought and Practice: Perspective on a Grand Dichotomy* (Chicago: University of Chicago Press, 1997).

As I explained in the Chapter 1, pragmatic regulatory coordination consists of complementary measures and processes necessary for securing stable, composed liberal financial order. Although the mechanisms and processes greatly overlap, the purpose is to generate conditions that guarantee desirable balance between innovation and growth, and between efficiency and systemic stability. Regulatory coordination does not only prevent, contain, or resolve market-related crisis; it ameliorates unproductive, speculative behavior characteristic of financial markets. It is a financial system-oriented practice that involves synchronized institutional supervision, cross-functional supervision, supervision by objectives, and consolidated supervision of market institutions and actors.[24] It is about critical financial policy measures and mechanisms that complementarily harmonize systemic goals and objectives of the capitalist political economy. To emphasize, the main purpose of regulatory coordination is to keep the political economy in competitive equilibrium; imbalance derails the economy from its axis of rotation.

3. RATIONALE FOR PRAGMATIC REGULATORY COORDINATION

At least three associated reasons explain the practical necessity for pragmatic regulatory coordination. First, regulatory coordination is the linchpin of the marketplace framework because of the *holism* of advanced liberal politics and finance; both are interminable burdens with cognate evolutionary principles and functions.[25] However, the principles of

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[24] See Hemendra Aran and Alpesh B. Patel, *Global Financial Markets Revolution: The Future of Exchanges and Global Capital Markets* (New York: Palgrave McMillan, 2006), 95-135. A similar analysis is found in International Monetary Fund (IMF), "Lessons of the Financial Crisis for Future Regulation of Financial Institutions for Liquidity Management," February 2009, available from http://www.imf.org/external/np/pp/eng/2009/020409.pdf (accessed August 11, 2010).

[25] For details on the cognate origin and functions of politics and finance, see Tilly, *Coercion, Capital, and European States*, 5, 16, 17.

finance are not quite scriptable. That is because its instruments and products are never wholly consistent with its innovative processes and spontaneous movements.[26] Although finance makes the global economy go round, it is a fragile interstitial parasite whose binding and integrative qualities as well as speculative and system destabilizing tendency affect the fabrics of societies in elemental ways.[27] A cognate burden requires shared management. That is exactly the case for politics and finance because the circulating as well as transformative power of the latter is contingent upon efficient organization of liquid capital markets.

Capital becomes liquid when market participants are able to convert assets and liabilities into purchasing power at agreed prices with ease and speed. That requires a sound financial system to channel resources from surplus savings units at competitive rates of return to deficit spending units for innovative and productive use.[28] However,

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[26] Investors, consumers and political systems are always vulnerable to financial crisis regardless of the verbiage of financial laws. This is because finance is a complex legal mystery. For evidence of why finance is quite un-scriptable, see Morgenson, "3,000 Pages of Financial Reform, but Still Not Enough."

[27] The role of finance in the emergence and consolidation as well as in the decay, collapse, and revival of polities, including empire-states and sub-states (either as a result of excessive capital flight—legal or illegal—a lack of inflow, sheer mismanagement, or as "the nerves of war") cannot be overstated. Paul Kennedy's theory of "imperial overreach" or "imperial overstretch"—resulting from the great powers' excessive financial cost of military engagement vis-à-vis their economic capacity—reinforces this claim. For details, see Kennedy, *The Rise and Fall of Great Powers*, 515. See also Tilly, *Coercion, Capital, and European States*. For details on role of global finance in the near collapse of Mexico, Argentina, Russia, and East Asia and African states in the 1990s, see Sylvia Maxfield, "Capital Mobility and Mexican Financial Liberalization," in *Capital Ungoverned: Liberalizing Finance in Interventionist States*, ed. Michael Loriaux, et el. (Ithaca and London: Cornell University Press, 1997): 92-119; Alemayehu Geda, "The Historical Origin of African Debt Crisis," *Eastern Africa Social Science Research Review*, Vol. XIX, No. 1 (January 2003): 59-89; Anna Gelpern, "Financial Crisis Containment," *Connecticut Law Review*, Vol. 41, No. 4 (May 2009).

[28] This point applies to developed nations with established, well functioning regulatory capacities. As Gelpern notes, poor underdeveloped countries that raise capital internationally occupy "an exotic corner of the financial universe." See Gelpern, "Domestic Bonds, Credit Derivatives, and the Next Transformation of Sovereign Debt," 147-148. See also Hideo Kurasaki, "Characteristics of Finance in Underdeveloped Countries," *The Developing Economies*, Vol. 1, Issue 2 (December 1963): 169-183; Levine "Financial Development and Economic Growth," 692; Stiglitz, "The Role of the State in Financial Markets," 23.

the channeling process is burdened with systemic risks, including social and political risks resulting from economic malaise—risks that intertwine with market liquidity, aggregation and dissemination of market-related information, interpretation of political processes and events, transfer of opaque credit instruments and problems that come with asset pricing. Potential investors usually evaluate these converging risks, mindful of short-term and long-term benefits, contract enforcement mechanisms, perceived rate of contractual default, and liability of contractual undertakings falling behind the purchasing value of contract denominated currencies. These risks get compounded by financial market (mis)behavior and insider-trading.[29] Nevertheless, it is absolutely right to say that risk drives financial markets, which in turn, makes the world economy go round.

In effect, the risk factor, the holism of politics and finance, and the uncertainties of financial markets mean that surplus saving units will give up control of their assets only when they are convinced or guaranteed in principle and in practice of safe return on their undertakings.[30] Thus, to ensure availability of investment funds (which is essential for wealth creation and organization of the political economy), liberal capitalist state authorities coordinate their financial systems in pragmatic regulatory ways that prevent/contain extraordinary credit crises. Coordination involves arms-length system insurance for investors and depositors, and may take the form of explicit policy or

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[29] For details on financial market risks, see Benoit Mandelbrot and Richard L. Hudson, *The (Mis)Behavior of Markets: A Fractal View of Financial Turbulence* (New York: Basic Books, 2004); Viral V. Acharya and Lasse Heje Pederson, "Asset Pricing with Liquidity Risk," *Journal of Financial Economics*, Vol. 77 (2005): 375-410; Germain, *International Organization of Credit*, 12; Floyd Norris, "The Upside of Reviving Securitizing," *New York Times*, September 30, 2010.

[30] Chris Giles, George Parker and David Oakley, "Gilts Lose Triple Lustre for Investors," *Financial Times*, March 1, 2010; Stiglitz, "Credit Markets and the Control of Capital;" Claude N. Rosenberg, *Stock Market Primer*, rev. ed. (New York and Cleveland: The World Publishing, 1969), 19.

implicit subsidy. Coordinating the price system ensures systemic economic stability.[31] That is because a relative certainty in the price of credit is critical for management of the broader economy. In other words, certainty about timing, exchange, and settlement of transactions make it comparatively inexpensive to trade credit instruments and contracts.

Second, pragmatic regulatory coordination is crucial because financial markets and institutions have fiduciary responsibility with other people's finances, which are concentrated and consolidated through diversified portfolio investments.[32] The use of other people's finances requires regulatory supervision not only because of imperfect market information, but because investors do not have ready access to detailed market activities. The state, however, has the capacity to compel disclosure of such details and can, as a result, prevent market authorities from abusing their trusted responsibilities. More importantly, the state compels disclosures because finance is information and, therefore, any systemic disruption of market-based information is disastrous for the system as a whole. Disaster will hinder the flow of capital from savings units to deficit spending centers. Being the systemic insurer, the state has implicit resolution authority to act in times of crisis, in ways that make the economy sound and healthy, in other words, the state has fundamental and emergency rights to intervene to prevent economic collapse. And it enforces regulatory supervision and compliance for the reason that it has the primary duty to protect investors and consumers, guarantee solvency of systemic

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[31] Stiglitz, "The Role of the State in Financial Markets," 20; Stiglitz, "Regulation and Failure," 11-23; George Magnus, "Markets Look for Political Leadership," *Financial Times,* March 10, 2010. Gelpern, "Financial Crisis Containment," 506-507; Levine "Financial Development and Economic Growth," 692.

[32] Louis D. Brandeis, *Other People's Money: And How the Bankers Use It* (Mansfield Centre, CT: Martino Publishing, 1913/2009), 4.

credit institutions, ensure competitive innovation atmosphere, stimulate growth, and improve macroeconomic stability.

The third reason derives from the fact that financial markets are not perfectly efficient or rational. Likewise, state actors have general limitations on what they know and can possibly know: humans generally have faulty perceptions. Pragmatism is, therefore, necessary because neither markets nor humans are perfect and rational; it is probability instead that underpins their successes.[33] In fact, Greenspan's admission of putting too much faith in the self-regulating market orthodoxy is a undeclared recognition of pragmatic regulatory coordination, however politicized the feedback process is.

I call the coordinated management approach "pragmatic" for two reasons. First, regulatory coordination is an embedded and expedient practice that sustains the values and goals of democratic capitalist states. It guarantees sound credit organization, ensures capability of their financial market institutions to allocate resources flexibly, efficiently, and strategically across political units in ways that prevent broad market dysfunctionality. Pragmatism strengthens the capacity of liberal financial systems to endure liquidity and other market risks that may otherwise cause systemic economic collapse.[34] Second, the processes are simultaneously re-regulatory and de-regulatory because: 1.) coordination is

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[33] Nassim Nicholas Taleb captures the inherent flaws in human thinking (broadly speaking) and the chances that underpin financial market practices, in particular. For details, see Taleb, *Fooled by Randomness: The Hidden Role of Chance in Life and in the Markets*, xiv; Taleb *The Black Swan: The Impact of the Highly Improbable*. David Brooks makes a similar argument in his "The Behavioral Revolution," *New York Times*, October 27, 2009.

[34] See Tucker, "The Repertoire Official Sector Interventions in the Financial System," 3; Timothy F. Geithner (then President and Chief Executive Officer, Federal Bank of New York), "Systemic Risks and Financial Markets" (Testimony before Committee on Financial Services, U.S. House of Representatives), July 24, 2008, available from http://www.ny.frb.org/newsevents/speeches/2008/gei080724.html (accessed March 23, 2011).

carried out by regulating agencies (public and private), self-regulating, and regulated entities; and 2.) the basic purpose is for the stability of the political economy. As noted in the earlier chapters, regulating entities include the three arms of government and their designated agencies. Self-regulating entities include *legally designated* "independent" market institutions that are strategic for systemic stability.

In this sense, pragmatic regulatory coordination creates public trust, confidence, and certainty that are crucial for the well functioning of liberal market system. As noted earlier, credit is based on public trust and confidence in the political system in which it is organized.[35] Confidence is crucial in prosperity and in adversity. It is in this sense that pragmatic coordination corrects market imperfections, meliorates distributional effects of finance, facilitates competitiveness in the broader market environment and ensures dynamic equilibrium in the political economy. It induces short-term and long-term sources of financing into sectors of the economy that are productive and/or strategic and guarantee systemic stability. In particular, pragmatic regulatory coordination prevents adverse selection tendencies, minimizes moral hazards and thwarts/allows monopolistic or oligopolistic conditions *when* and *where necessary*. This is the essence of pragmatic regulatory coordination: advanced liberal capitalist state actors evaluate the *practical consequences* of finance and deal with them as such.

Pragmatism—as the subtitle of William James' popular lectures on philosophy explains—is a "new name for some old ways of thinking" about/or settling metaphysical

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[35] See Andrew G Haldane, "Credit is Trust" (speech, given as Executive Director, Financial Stability, at the Association of Corporate Treasurers, Leeds, U.K, September 14, 2009, available from http://www.bankofengland.co.uk/publications/speeches/2009/speech400.pdf (accessed May 7, 2010). See also *An Address by Senator Nelson W. Aldrich*, 3.

problems "that otherwise might be interminable."[36] Pragmatism as an old principle for thinking about relationship of politics and finance is discussed in Plato's *Republic*. We understand from this work that a person who is good at keeping a thing is equally good at stealing it or as Plato put it, "if the just man is good at keeping money safe he will be good at stealing it too."[37] In other words, if the *just men* (regulating entities) are good at regulating regulated bodies, then the *unjust men* (or regulated entities) are excellent at contriving unjust regulatory objectives and practices. It is for this reason that a stable and efficiently organized financial system requires pragmatic regulatory coordination involving regulating, regulated, and self-regulating entities. Doing so is a recognition of the fact that regulators do not have absolute knowledge and understanding of the tangled structures of finance. Their perceptions and skills are as limited and distorted as those who manage the financial system, whose instruments and products are always complex, opaque, and puzzling.[38] Apart from their limited knowledge and distorted views, both the

[36] The "pragmatic method," James wrote, "is primarily a method of settling metaphysical disputes that otherwise might be interminable." See William James, *Pragmatism: A New Name for Some Old Ways of Thinking: Popular Lectures on Philosophy* with Introduction by Bryan Vescio (New York: Barnes & Noble, 1907/2003), 23. The mystery of finance fits this definition; it is an interminable phenomenon.

[37] Plato's point is understood in a broader context in which he noted that "in boxing and other kinds of fighting, skill in attack goes with skill in defence," just as "the ability to save from disease [implies] the ability to produce it undetected." See Plato, *The Republic*, trans. Desmond Lee (1987), 11.

[38] The most complex financial products, instruments and processes are associated with derivatives markets. Derivatives markets—the most complex subtype of financial markets—are opaque for at least two reasons. First, they are organized over-the-counter in obscure, uncertain futures trading settings dominated by key participants (including controlling shareholders, firm managers, and board of directors) with access to non-public market information. Second, the value of the underlying assets depends on future price movement, which means that paper contracts are generally not as solid and honest as the assets against which they are claimed. That is to say contracts are not close to the material realities they represent. These interlocking exchange processes and instruments contain risk. For details on derivatives markets, see Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, "Investor Protection and Corporate Governance," *Journal of Financial Economics*, 58 (2000), 4. Morgenson, "3,000 Pages of Financial Reform, But Still Not Enough."

just and *unjust* men and women have "selective incentives"[39] in managing their cognate burden. As Mancur Olson argues, selective incentives underpin joint production of public goods. To achieve a mutually desired public good requires restraint of passion, as discussed in Aristotle's *Politics*. In the context of the political economy, moderation of passion requires synchronization of supposed contradictory logics of politics and finance. Thus, pragmatic regulatory coordination is not for itself; it is for the resilience, stability, and efficiency of advanced liberal capitalist states and the states system. Through this mechanism, political actors and credit market authorities create and sustain trust in their financial systems, doing so within democratic-institutional structures.

4. COMPONENT CATEGORIES OF MARKETPLCE RELATIONS

As indicated in the Chapter 1, the major component categories of the marketplace relations include ensuring systemic security and stability, creating asset representation systems, enforcing contractual and property rights, guaranteeing investors' confidence and depositors' trust, and explicit and implicit assurance by political actors to manage systemic financial shocks/crises. The goal here is to provide details on these categories.

I. Systemic Security and Stability

Systemic security, which includes physical/political security and economic stability, is fundamental for efficient organization of credit. Stability is defined in terms of the way financial market institutions create, package, and distribute credit instruments vis-à-vis the economy. Such is fundamental to the security of the liberal capitalist state because of

[39] Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups* (Cambridge: Harvard University Press, 1965), 51, 61.

the inherent paradox of democratic capitalism.[40] Economic stability is measured by the absence of consistent fluctuations in the economy. Instability often results from unstable inflation, unbalanced economic growth, and frequent financial panics/crises. Economic contractions usually stem from fragile financial systems, asymmetric market information problems, a buildup of credit market risks, lack of market transparency, and structural imbalance between the financial innovation and stability of the "real" economy.

To reduce market risks and economic disruptions, liberal capitalist authorities create broad institutional arrangements underpinned by effective payments and funding structures. These structures include explicit/implicit political and social safety nets with liquidity insurance for systemic and strategic market institutions. They allow financial market authorities, including "information-legitimizing" agencies[41] to responsibly engage in competitive innovation and value creation. Competitive innovation and economic growth, however, depend on formal system of property and contractual rights. My understanding of the mystery of formal property rights and assets representation systems is enhanced by the clarity provided in Hernando de Soto's *The Mystery of Capital*.

II. Formal Property Rights System

The "linchpin" of a free market economy (or the marketplace framework in this case) is property rights.[42] Property rights system is so described because asset representation and

[40] See Greider, *Secrets of the Temple*, 11.

[41] See details on "information-legitimizing" institutions in Keohane and Joseph S. Nye, "Power and Interdependence in the Information Age," 92.

[42] For details, see Greenspan, *The Age of Turbulence*, 139. See also Burch, "Constituting IPE and Modernity," 23.

management are rooted within it. A legal system of property rights is not only a means of appropriating resources; it is also an instrument for motivating people to generate extra usable value.[43] Enforcement of those rights and respect for contractual undertakings are fundamental to the functioning of the marketplace framework. Embedded in those rights are systemic guarantees by political actors to manage inherent risks in financial markets. Guarantees are necessary because the implied contract and protective mechanisms in formal property rights system help to unearth potential values of physical asset and human capital. In other words, formally documented titles in a system of property rights is the interlocking mechanism that fixes economic potentials of resources into financial capital.[44] In fact, only a few individuals and institutions will risk their assets in a political system where there are no guarantees of property and contractual rights.

In essence, an enforceable property rights system, the sense of asset security, and liberty of life in the regulatory coordinated marketplace framework make innovation, investment, and exchange of ideas/goods and services flexible, enticing, and contagious. This framework functions well because the enforceable system of property rights makes coordination of market-oriented behavior possible. The rules and obligations of a formal property rights system—the accountability it creates, the constraints and opportunities that come with it and the sanctions it imposes—are behavior coordinating processes. Closely linked with property rights is formal asset representation system.

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[43] For details regarding the virtue of asset representational system and property rights, see de Soto, *The Mystery of Capital* 215*;* Simon Johnson, John McMillan, Christopher Woodruff, "Property Rights and Finance," *The American Economic Review*, Vol. 92, No. 5 (December, 2002): 1335-1356. See a condensed version of de Soto's "The Mystery of Capital" in *Finance and Development*, Vol. 38, No. 1 (March 2001).

[44] de Soto, *The Mystery of Capital*, 46.

*III.	Formal Asset Representation System*

If the linchpin of the advanced liberal capitalist economy is property rights, then asset representation system is the epoxy that makes the marketplace framework efficient, integrating, and engaging. Representational systems enable assets to lead what de Soto calls "an invisible, parallel life alongside their material existence." Representation in codes, numbers, symbols, and percentages is the process of efficiently documenting the rights of property ownership. Documentation takes two forms: public and private record keeping services. Whichever form it assumes, representation is the lifeblood of the marketplace framework; without it assets are "dead capital." In that sense, exchange cannot take place. Representation provides vital information on resources, including their economic potentials and history of ownership and transfers (if any). Contained in such information are competitive and locational advantages of resources—advantages that are critical for investment considerations.[45]

Asset representation entails the right to own as well as the right to engage in property transfer. It enables permissive, interlocking conditions that shape marketplace relations. Permissive conditions comprise reduction in transaction expenses, including monitoring and administrative enforcement costs that underpin collection and processing of market-related information for potential investment. Six reasons support this point.

First, the market-related news that information-legitimizing institutions collect and store on privately owned, but publicly registered virtual 'switchboards' are protected,

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[45] On invisible parallel life of assets, see de Soto, *The Mystery of Capital*, 6. On locational advantages of resources, see Sassen, *The Global City*; Clark, "London in the European Financial Services Industry." See also Timothy Besley, "Property Rights and Investment Incentives: Theory and Evidence from Ghana," *Journal of Political Economy*, Vol. 103, No. 5 (October, 1995): 903-937; Lester C. Thurow, "Needed: A New System of Intellectual Property Rights," *Harvard Business Review*, (September-October, 1997): 94-103.

tracked, monitored, and disseminated with ease. That allows faster recording, execution, and enforcement of contractual undertakings. The switchboards enable the investing public to interact in interminable networks of demand and supply. Network effects take place as a result because the virtual switchboards allow connectivity between and among registered market participants.[46] A high rate of connectivity makes transaction costs of mobilizing and trading financial instruments relatively inexpensive. As lower transaction costs are incentives to trade, they allow information to spread between potential lenders and ultimate borrowers. Contracts are entered or abrogated with speed. Registration makes such speedy processes possible. It provides incentives for innovation/investment in growth generating technology, which in turn, is essential for efficient organization and dissemination of market-related information and products.

Second, representation makes standardization of economic values possible, as it allows incorporation of assets with definitive liability. That makes it easy to convert or combine whole or parts of fixed/movable assets into shares for contractual undertakings. Conversion allows exchange between supply and demand for loanable funds as document of ownership rather than actual resource becomes the instrument of contractual transfer.

Third, effective representation makes resources fungible and exchangeable with a regulated exposure to risk. That is because representation provides facts on the solvency of economic institutions and market participants to potential investors who are either interested in entrusting funds to or accepting funds from organizations and individuals with business interest. Supervised and fully "legitimized" market information improves

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[46] See Matt Richtel, "Your Brain on Computers; Hooked on Gargets, and Paying a Mental Price," *New York Times*, June 7, 2010.

prevention of moral hazards, adverse selection and corporate fraud, misallocation of funds, free-rider problems, and other tradable risks and impediments in the broader exchange process. That is to say efficiently legitimized information makes the market system elastic. A flexible and democratically coordinated exchange system is the peculiar excellence of advanced liberal capitalist economy. Flexibility shaped by pragmatism is the basis of confidence and trust in advanced liberal capitalism. That, to use the words of Joseph Nye is the "soft power" of attraction characteristic of these kinds of states.[47]

Fourth, representational force makes potential values perceptible, accessible and tradable across space. Representative documents rather than physical assets are bought and sold within and outside the territorially-based capitalist exchange systems between registered market participants who do not necessarily know or like one another. That happens because participants do not have to move physical resources around for trade to take place. What they exchange is authenticated entitlements showing economic values. In this sense, registered assets help to integrate unsecured segment of the global economy into the virtual information market with unlimited options and choices for market players.

The virtue of representation lies in the fact that while surplus savings units hold eligible collaterals such as equities and bonds, financial market institutions (re)package and rebrand those liquid instruments into long-term financing of illiquid assets. The fungible nature of representative documents helps to change savings and lending rates as well as investors' habits of mind. With information, almost all aspects about tradable resources are collated and brought from the periphery of the economy into mainstream

[47] See Joseph Nye, Jr., *Soft Power: The Means to Success in World Politics* (New York: Public Affairs, 2004).

life of property laws. In this sense, market information is not limited to economic values of resources alone, it is available for the legal rules that govern lives and values.

Fifth, representation of assets creates conceptual space for the investing public to move beyond the primary value of resources to thinking about their potential values. In other words, the permissive and intertwining force intrinsic in asset representation allows economic agents to think beyond the immediate usefulness of resources to thinking about their extra values. Resources *are* what we *think and make* of them, for as Aristotle notes in his *Metaphysics*, the actual and potential existence of things are somehow the same, but the value of the actual increases indefinitely when we focus our train of thought on their potentials.[48] That is to say the perceptive mind focuses more on potential values rather than actual resources, and that is what creates wealth. Wealth creation requires concentration of thought on potential values. That is because the perceptive mind identifies and integrates evidence of potential existence via intangible values in material things. Thinking creates extra value out of resources; over reliance on primary values breads deficiency. In sum, representation allows focus of thought and energy on potential rather than primary values of assets. That is how "surplus value" gets extracted.

In essence, representative system helps to simplify as well as combines complex reality of resources and their actual/potential values into their lowest essential terms for the investing mind to understand, process, manipulate, integrate, synthesize, differentiate,

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[48] Aristotle, *The Metaphysics*, transl. Hugh Lawson-Tancred (London: Penguin Books, 2004) 383. As Aristotle remarks elsewhere, "thinking and speculation that are their own end and are done for their own sake are *more* 'active,' because the aim in such thinking is to do well, and therefore, also in a sense, action" (emphasis in translation). See Aristotle, *The Politics*, trans. Thomas Alan Sinclair (1962), revised trans. Trevor J. Saunders (London: Penguin Books, 1981, reprint, 1992), 401.

coordinate, (re)produce, (re)connect, and harmonize for wealth creation.[49] Backed by impersonal social capital, representation of assets dematerializes all forms of relations and allows individual, governments, and investment institutions to exchange impersonal securities in primary and secondary markets of advanced capitalist states. They invest in government obligations (bonds, notes, bills, etc), commercial bank savings deposits, life insurance and pension funds, and corporate securities (corporate bonds, common and preferred stocks), etc.[50] This creates interactive space for resident and non-resident market players brimming with speculative energy and innovative ideas to "freely" engage in transnational 'democratic' process of risk taking in investment and production that are distinctive of liberal market economies. They may participate in different kinds of transactions, including bonds and currency transactions, thus claiming a stake in the great game of capitalist states.[51] The greatness of this game lay in its transnational nature backed by property rights. These kinds of relations do not happen through the prism of tension as the tension framework suggests; they are grounded in pragmatic regulatory coordination via asset representation system.

IV. Regulation, De-regulation, Re-regulation

At this juncture, two issues need clarification. First, the term pragmatic regulatory coordination covers concepts such as regulation, re-regulation, de-regulation, self-

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[49] de Soto, *The Mystery of Capital*, 218-219.

[50] See James Politi, "Fed Efforts Boosted by Treasury's $200bn Debt Plan," *Financial Times*, February 24, 2010; Rosenberg, *Stock Market Primer*, 19.

[51] When ordinary people have the possibility to invest and buy luxuries, it creates a "consumer revolution" that makes many people "willing to work harder," which results in greater productivity. See Gordon S. Wood, "Inventing American Capitalism," *New York Review of Books*, June 9, 1994, 49.

regulation, self-deregulation, credit crisis prevention, crisis resolution, and crisis containment[52]—concepts that broadly define relationships between states and market institutions. The underlying theme in the literature on *regulation* seems to focus on *political control* of market processes and market participants. But "regulation" need not necessarily be about external action as in the case of government agencies shaping behavior of market institutions and participants to, for instance, reduce risk or prevent oligopolistic conditions. That is because role of liberal capitalist states in financial markets is at the same time a (de)regulatory affair as it is a re-regulatory process.[53] In this sense, the term regulation and all of its altered forms do not quite capture the nature of relations between advanced liberal capitalist authorities and their financial market counterparts. Pragmatic regulatory coordination captures it better.

Second, the usual understanding of "regulation" and its derived forms appear to center exclusively on executive (implementing community) and legislative branches of government and their specialized market agencies. For instance, some analysts use the term "prudential regulation" to mean supervision of "restricted" component institutions of financial systems by executive and legislative arms of government. Banks are usually those component institutions.[54] But the term is not systemic and comprehensive in scope

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[52] Gelpern analyzed some of these concepts in her "Financial Crisis Containment," 505-509. See also Peter Moosleschner, Helene Schubert, Beat Weber, ed., *The Political Economy of Financial Market Regulation* (Cheltenham, UK.: Edward Elgar, 2006); Roger G. Noll and Bruce M. Owen, *The Political Economy of Deregulation: Interest Groups in the Regulatory Process* (Washington, D.C. and London: American Enterprise Institute for Public Policy Research, 1983).

[53] My use of the term is consistent with Cerny's argument that financial market regulation or deregulation is, in effect, a re-regulatory process. See Cerny, "The Deregulation and Re-regulation of Financial Markets in a More Open World," 52; Cerny, *Rethinking World Politics*, 146.

[54] Paul Tucker, Deputy Governor of the Bank of England (in charge for financial stability), made reference to the restricted use of "prudential regulation." See Tucker, "The Repertoire Official Sector

because those restricted market players are not the only important financial actors; non-bank financial institutions are increasingly involved in packaging and selling of complex securities. Additionally, the instruments of prudential regulation tend to center on net capital requirements and supervisory inspection. In contrast, the component elements of pragmatic regulatory coordination are not limited to regulating and "controlled" market actors; they include regulating, regulated, and systemic self-regulating institutions.[55]

The pragmatic regulatory concept covers financial market-oriented institutions that are not only objects of regulation and deregulation, but also active subjects of coordination. They include public and private (not-for-profit) financial market authority structures such as legislative and executive arms of government (with their regulatory agencies), securities and futures exchanges, transnationalized market information-legitimizing institutions, and bankruptcy as well as superior courts of law.[56] Effective coordination among these authority structures creates public confidence and trust in the broader economy. Confidence and trust are generated through conscious policy choices that are guaranteed and reinforced through what Strange calls "politically determined

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Interventions in the Financial System." For restricted supervision of asset holding financial institutions, see Frederic S. Mishkin, "Prudential Supervision: Why Is It Important and What Are the Issues?" *National Bureau of Economic Research Working Paper Series*, Working Paper 7926, September 2000, available from http://www.nber.org/papers/w7926.pdf (accessed February 22, 2010), 1-9; Mathias Dewatripont and Jean Tirole, *The Prudential Regulation of Banks*, 2nd printing (Cambridge, MA: MIT Press, 1999).

[55] This point is in line with Sam Peltzman's argument that regulatory agencies should not "exclusively serve a single economic interest." See Peltzman, "Toward a More General Theory of Regulation," 211. See also IMF, "Lessons of the Financial Crisis for Future Regulation of Financial," 8-9.

[56] For details on the role of liberal legal system regarding the marketplace framework see, for instance, United States Supreme Court, "Stoneridge Investment Partners, LLC vs. Scientific-Atlanta, Inc. and Motorola, Inc. on a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit," August 15, 2007, http://www.abanet.org/publiced/preview/briefs/pdfs/07-08/06-43_Petitioner.pdf (accessed March 14, 2010); Federal Communications Commission v. AT&T Inc., 562 U.S. (2011). Alan Greenspan was unequivocal in the importance of laws and conventions in a free market economy. See his *Age of Turbulence*, 139.

laws and administrative decisions."[57] Conscious decisions reflect the interlocking nature of pragmatic regulatory coordination, which requires complex sets of policies to ensure solvency of financial market institutions and stability of the political economy.

V. Containing Risk, Generating Confidence, Sustaining Trust

To generate confidence and sustain public trust in property rights, asset representation system and financial products and instruments, liberal state actors contain contradictory and destabilizing tendencies of finance. The mechanisms and processes are economic, political, and judicial in nature. The economic dimension consists of providing stable currencies, sound fiscal policies, and effective system of managing monetary impulses. The political dimension involves ensuring integrity and stability of the financial system and the entire economy. That entails establishing some coordinated restriction on systemically risky incentive schemes that market participants tend to design and trade. They include separating ownership and control of publicly registered firms, monitoring and supervising "insider" activities, capital requirement, net worth declaration for banks and insurance companies, and unusual political processes that are necessary for stable financial system. Judicial dimensions include enforcement of consumer and shareholder protection laws, administration of antitrust regulations, and information disclosures that help investors make independent decisions.[58] These component elements make advanced liberal economy stable, flexible, and relatively efficient.

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[57] Strange, "Finance, Information and Power," 263.

[58] See for instance, David G. Savage, "Corporations Don't Have 'Personal Privacy Rights,' Supreme Court Declares," *Los Angeles Times*, March 2, 2011.

In sum, building investor confidence and systemic protection for financial markets is the first critical condition for the smooth functioning of the marketplace framework. The loss of public confidence negatively impacts the political system itself. A deficit of public confidence may result from two sources: negligence of responsibility and lack of expediency. Inexpedient regulatory measures often include uncoordinated competition, ineffective monitoring system, absence of complementary supervision, and dearth of enforcement of rules and standards that are critical for smooth working of the liberal market economy. Such may also result from a combination of profit stealing by corporate managers, large-scale asset stripping, excessive consumer price inflation, insider trading. It may also result from absence of clear rules where necessary and lack of extraordinary political action when needed. Ineffectiveness in this context means the combination of poor market related outcomes and lack of regulatory *pragmatism*.

5. MAJOR SITES OF REGULATORY COORDINATION

As indicated previously, regulatory coordination is managed and enforced by advanced liberal capitalist states and their specialized agencies together with self-regulatory, non-governmental organizations that are structurally private and functionally nonprofit. U.S. regulating agencies include Securities and Exchange Commission (SEC) and Commodity Futures Trading Commission (CFTC). They are respectively responsible for enforcing federal securities and commodity related laws and regulations. Non-governmental self-regulatory institutions include established stock and options exchanges and Financial

Industry Regulatory Authority (FINRA).[59] An example of U.S. government mandated self-regulatory (not-for-profit and member-funded) organization is the Securities Investor Protection Corporation (SIPC).[60] The Financial Services Authority (FSA) is the independent non-governmental single financial industry regulator in the U.K.[61] Its board of regulators is appointed by The Treasury.

The point being made here is that some of these independent organizations were created by their respective governments as non-governmental organizations to perform duties and responsibilities that are strategically political in nature. And they do so by coordinating their functions (together with political institutions) across national borders.[62]

That said, information about economic resources in the capitalist system does not just exist; it is created in a competitive manner. Market information is part of intellectual property rights that is compensated for because compensation drives reinvestment.[63] Competitive information enables financial markets allocate fungible assets efficiently in

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[59] The FINRA "is the largest independent regulator for all securities firms doing business" in the U.S. It oversees "nearly 4560 brokerage firms, about 163,335 branch offices, and approximately 631,305 registered securities representatives." For details, see "Financial Industry Regulatory Authority," available from http://www.finra.org/AboutFINRA/ (accessed April 14, 2011). See also Carrie Johnson, "SEC Approves One Watchdog for Brokers Big and Small," *The Washington Post*, Friday July 27, 2007.

[60] The Securities Investor Protection Corporation was created by an act of Congress in 1970 as a non-profit member-funded corporation to protect securities investors from financial harm if a broker-dealer firm fails. For details, see Securities Investor Protection Act of 1970 (15 U.S.C., amended December 4, 1987), available from http://www.sipc.org/pdf/SIPA.pdf (accessed April 14, 2011).

[61] U.K., "Financial Services and Markets Act 2000," available from http://www.legislation.gov.uk/ukpga/2000/8/pdfs/ukpga_20000008_en.pdf (accessed April 17, 2011).

[62] For a typical example of a "formal basis" of coordination/cooperation between U.S. and U.K. regulating and self-regulating authorities, see "Memorandum of Understanding between Financial Industry Regulatory Authority, Inc. (FINRA) and Financial Services Authority (FSA)," September 15, 2010, available from http://www.fsa.gov.uk/pubs/mou/fsa_finra.pdf (accessed April 16, 2011).

[63] Keohane and. Nye, Jr., "Power and Interdependence in the Information Age," 85-88.

ways that, when well coordinated, restructure the economy. Credit rating agencies are critical in regulatory coordination; they integrate and circulate information among savers, borrowers and investors about management and viability of market institutions. They provide credible and coherent information, including accounting standards and disclosure rules. Robert Cox refers to them as part of "transmission belts" in globalization.[64]

Information-legitimizing institutions/transmission belts include transnationalized bond and credit market rating agencies—known in the U.S as Nationally Recognized Statistical Rating Organizations.[65] Those with global reach include Standard & Poor's (S&P) Rating Group, Moody's Investors Service and Fitch Group. The first two are of U.S. origin, and are headquartered in New York City. Fitch, which has comparatively a small global market shares, is headquartered in New York City and London and controlled by a France-based risk management corporation. U.S. stock market index tracking firms include Dow Jones Industrial Average (Dow) and NASQAD Composite. The FTSE Group, which is jointly owned and maintained by *Financial Times* and the London Stock Exchange, tracks stock market indices for British companies and investors.

In essence, most of transmission belts, including established stock exchanges are state-sponsored oligopolies. Although their institutional structures and national origins

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[64] On "transmission belts," see reference in Timothy J. Sinclair, "Between State and Market: Hegemony and Institutions of Collective Action under Conditions of International Capital Mobility," *Policy Sciences*, Vo. 27, No. 4 (December 1994), 448. As Mishkin observes, "A critical impediment to efficient functioning of the financial system is asymmetric information, a situation in which one party to a financial contract has much less accurate information than the other party." See Mishkin, "Prudential Supervision." See also Rafael La Porta et el., "Investor Protection and Corporate Governance," 6.

[65] See U.S. Securities and Exchange Commission, "Credit Rating Agency Reform Act of 2006," available from http://www.sec.gov/rules/final/2007/34-55857.pdf (accessed April 21, 2010); "Report on the Role and Function of Credit Rating Agencies in the Operation of the Securities Market," January 2003, available from http://www.sec.gov/news/studies/credratingreport0103.pdf (accessed April 21, 2010). For a scholarly analysis of the functions of these agencies, see Sinclair, "Between State and Market," 448.

differ, their roles are competitive and complementary in nature: they serve as agents of both capitalist states and their investment firms. Their roles are critical in a globalizing world economy in which credit organization has become more information-intensive. Although they are state-sponsored agencies, not all information transmitted is accurate and reliable, particularly where vital, strategic investment information can slip by as a result of the burst of data.[66] The chance of strategic information slipping away helps to clarify why pragmatic regulatory coordination of credit information industry is crucial.

Highlighting the judicial component of regulatory coordination helps explain the marketplace framework well. The legal dimension is the nexus and source of sustenance of advanced liberal financial governance. As Chief Justice Charles Hughes makes clear in 1932, "we are under a Constitution, but the Constitution is what the judges say it is."[67] The marketplace framework revolves on the trust and confidence embedded in the liberal legal system not only because finance is a vast legal mystery of percentages of securities, derivative contracts, equities and other negotiable market instruments,[68] but because contractual relations are structured on it. Contractual relations depend on *property rights*, determination of which is largely the preserve of the legal system. In effect, regulatory coordination involves systemic financial hedging and enforcement of contractual rights.

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[66] See Matt Richtel, "Your Brain on Computers; Hooked on Gargets, and Paying a Mental Price," *New York Times*, June 7, 2010. For a detailed discussion on statutory, non-competitive market institutions and monopolies, see Claire A. Hill, "Regulating the Rating Agencies," *Washington University Law Quarterly*, Vol. 82 (2004); David Herszenhorn, "Senate Acts on Credit Rating Agencies," *New York Times*, May 13, 2010; Jerry W. Markham, "The Commodity Exchange Monopoly—Reform Needed," Washington and Lee Law Review, Vol. 48 (1991): 977-1036.

[67] See this quote in William H. Rehnquist, "The Notion of a Living Constitution," *Texas Law Review*, Vol. 54, No. 4 (May 1976), 698.

[68] This point corroborates Brooksley Born's view of "markets as an animal force" that are necessary capitalist society but must be "contained by law and regulation." See Hirsh, *Capital Offense*, 6.

In essence, judicial policies are not self-executing; they can only be translated into action by the executive arm of the state. Nevertheless, they are "authoritative" interpretations of exchange related mechanisms.[69]

At the heart of pragmatic regulatory coordination are central banks. The strength of the financial systems of the economies being examined depends on their central banks. Central banks in general are neither commercial nor investment banks; they are market makers of last resort. They are the sole depository of government funds out of which public payments, including payments of interest on government debts are made. They hold adequate capital reserves of commercial and investment banks, pay zero interest on deposits, and guarantee protection of their credit systems with high concentration of liquidity reserves. In essence, central banks occupy the center of the financial system with primary responsibility for systemic risk management.

Thus, the central bank of each state is in competition with absolutely no other economic institution within the state. Its primary role is economic stability, which it performs by shaping market behavior through monetary policy instruments—controlling money supply via inflation targeting. This privileged position allows central banks to regulate the financial system and, in effect, the economy. As Paul Tucker of the Bank of England rightly put it, "everything about central banking stems from [the central bank's] liabilities being the base money of the economy. From this flow our roles in monetary

[69] Judicial policies are political not only because superior and lower courts as well as non-judicial actors rely on political agencies to implement their policies, but the implementation processes are subjected to political cross-pressures. As such, the dynamics of judicial policy implementation and the compliance (or noncompliance) responses should be conceptualized and studied as complex political processes instead of as pure legal processes. For details, see Bradley C. Canon and Charles A. Johnson, *Judicial Policies: Implementation and Impact*, 2nd ed. (Washington, D.C.: Congressional Quarterly, 1999), 1-17, 26, 87, 161.

policy and financial stability."[70] In other words, the primary function of the bank of last resort includes supply of money stock and control of interest rates. They are, as Tucker noted, the "market maker of last resort;" i.e., they provide capital of last remedy. That is, central banks intervene implicitly/explicitly in their respective financial systems (often in coordinated ways) by maintaining aggregate market liquidity that each consider strategic and necessary in any given period of time. They are systemic insurers of financial market institutions—a condition that prevents the economy from overheating.

In this sense, the success of an advanced liberal financial system depends on the success of their central banks. However, the politics entailed in their obligations are not discussed and acknowledged publicly, although the banks are established by legislative acts. They are embedded in regulatory coordination structures as "independent" of politics. As Clive Crook pointed out, until the 2008 global financial market crisis hit the "independence" of central banks in laissez-faire market states was "an article of faith" rather than politics. [71] Irwin Morris provides the basis of this thinking when he observes that "early studies of monetary policy-making were founded on the assumption that the [Federal Reserve System] was a nonpolitical, social welfare-maximizing bureaucracy."[72]

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[70] What this means is that effective management of interest rates channels and distributes surplus savings to competing investors. See Tucker, "The Repertoire of the Official Sector Intervention in the Financial System," 2. For details on interest rate targeting by the Federal Reserve from the mid-1980s until the 2008 financial crisis, see Roger W. Garrison, "Interest-Rate Targeting During the Great Moderation: A Reappraisal," *Cato Journal*, Vol. 29, No. 1 (Winter 2009).

[71] Clive Crook, "Central Bankers Get with the Politics," *Financial Times*, May 16, 2010.

[72] Irwin L. Morris, *Congress, The President, and the Federal Reserve: The Politics of American Monetary Policy-Making* (Ann Arbor: University of Michigan Press, 2000), 4. See also J. Lawrence Broz, *The International Origins of the Federal Reserve System* (Ithaca and London: Cornell University Press, 1997); Greider, *Secrets of the Temple*.

In fact, when all is said about the marketplace framework, central banks cannot be considered "independent" of politics, for as the late Senator Edward Kennedy once noted, "much of what passes as [Fed's] economic policy is really about politics."[73] Indeed, the role of central banks in the integrated marketplace framework is maintenance of systemic economic stability. Their monetary policy and liquidity management mechanisms are the core of pragmatic regulatory coordination—is the superglue keeping the liberal political economy stable, relatively strong, and attractive to investors. Regulatory coordination is crucial for preventing central banks' "monetary policy errors," including holding interest rates too low or too high for far too long. As liquidity adjustment is the single essential condition for pragmatic regulatory coordination, too much expansion of credit for a long period of time is dangerous to the health of the political economy: it can cause inflation. On the other hand, too little credit for too long is equally bad: it can lead to deflation recession. Pragmatism is the watchword word.

Essentially, through such multiple, coordinating institutions and agencies—intended to monitor one another[74]—that political authorities of the liberal states design specific policy measures, financial service standards and laws, including accounting, taxation, subsidies, and bankruptcy procedures that have deliberate or non-deliberate impact on financial markets and the world economy. Doing so protects investors' interest, generates confidence, and sustains the flow of both public and private credit.

[73] See Senator Kennedy's comment on the fly leaf (first inside cover page) of Greider's *Secrets of the Temple: How the Federal Reserve Runs the Economy* cited above.

[74] Stiglitz, “The Role of the State in Financial Markets,” 13.

But one may justifiably ask: if the marketplace framework functions efficiently as described, why do financial market failures occur in advanced liberal capitalist states?

6. FINANCIAL MARKET CRISIS AND FAILURES

The basic answer is lack of absolute commitment to pragmatic coordination. The lack of commitment may result from what analysts call "competition in laxity,"[75] which takes at least three forms. First, it involves regulators competing among themselves for showy status of the number of regulated entities they supervise instead of coordinating their functions. Second, competition in laxity involves political authorities allowing financial market institutions to operate according to the latter's own internally generated rules and standards. That may result from unwillingness of state authorities and their financial market counterparts to sensibly perform coordinating roles. Crises occur when political actors allow financial markets to "outgrow" them.[76] Third, lack of systemic regulatory coordination may result from the fact that strategic individual political actors may have personal incentives to allow financial markets to operate according to their own rules and risk assessment models. That is to say the interests of both the *just* and *unjust* men often overlie such that protected investors usually are members (or associates) of systemic coordinating bureaucrats. The lack of separation is clearer where appointed officials are

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[75] Ann B. Matasar and Deborah D. Pavelka, "Federal Banking Regulators' Competition in Laxity: Evidence from CRA Audit," *International Advances in Economic Research*, Vol. 4, No. 1 (February, 1998): 56-69; Dale D. Murphy, *The Structure of Regulatory Competition: Corporations and Public Policies in a Global Economy* (Oxford: Oxford University Press, 2004), 7-8; Donald F. Kettl, "The Savings-and-Loan Bailout: The Mismatch between Headlines and the Issues," *Political Science and Politics*, Vol. 23, No. 3 (September, 1991), 443; William K. Black, *The Best Way to Rob a Bank is to Own One: How Corporate Executives and Politicians Looted the S&L Industry* (Austin: University of Texas Press, 2005), 17-40.

[76] See Susan Strange, *Mad Money: When Markets Outgrow Governments* (Ann Arbor: University of Michigan Press, 1998).

from among former financial market participants, and vice versa.[77] Such individuals know well that the state being a systemic insurer would unwillingly bear the cost of their negligence and excessive risks by intervening to save markets.[78]

That is to say that negligence of regulatory coordination ferments extraordinary credit crisis. It generates distrust, erodes confidence, and leads to financial system abuse.[79] System abuse happens when authorities exhibit narrowly defined vision instead of broad-based visionary strategy for managing the political economy. Abuse may take the form of unregulated greed, cheating, and disrespect for regulatory standards and processes. When that happens, risk builds-up disproportionately.[80] Disproportionate risk occurs when structural imbalance shifts relational arrangements of the marketplace from its coordinated equilibrium, and when financial market institutions take their existence and operations as a "given" instead of recognizing that their existence and usefulness depends on public confidence. In other words, imbalance happens when bureaucrats veer off uncoordinated routes, when regulatory coordinators fail to adhere to pragmatic values,

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[77] For an unambiguous analysis regarding how corporate market actors and politicians cooperate in regulatory laxity in savings and loans industry, for instance, see Black's *The Best Way to Rob a Bank is to Own One: How Corporate Executives and Politicians Looted the S&L Industry*; Michael Lewis, "For the Love of Money: Why Central Banks and Speculators Need Each Other" (Review Essay), *Foreign Affairs* (March/April, 1995), 141.

[78] Raghuram G. Rajan and Luigi Zingales, *Saving Capitalism from Capitalists: Unleashing the Power of Financial Markets to Create Wealth and Spread Opportunity* (New York: Crown Business, 2003).

[79] See Francesco Guerrera and Henny Sender, "Goldman Sachs Accused of Subprime Fraud," *Financial Times*, April 16, 2010; Henny Sender and Stephanie Kirchgaessner, "Blankfein Back Fights on SEC Case," *Financial Times*, April 22, 2010; Craig, Murphy, "Can Finance Be Made the Servant Again? (Review Article), *Mershon International Studies Review*, Vol. 40, No. 2 (October 1996): 332-335; The World Bank, *World Development Report 1989*, 26.

[80] "Geithner Testimony on Financial Regulatory Reform," *Financial Times*, November 19, 2009. This reference source was Secretary of the Treasury, Timothy F. Geithner's written testimony before the Joint Congressional Economic Committee on Financial Regulatory Reform.

and when as Greenspan put it, authorities *swap* "principle for power" and *end* "up with neither."[81] The principles of pragmatic regulatory coordination cannot be traded for power and for the sake of sake. Uncoordinated market life is simply unsustainable. Financial crisis will always be a part of advanced liberal capitalism because finance will remain the core of its structural organization. Commitment to restructuring the system to reflect pragmatism under all circumstances is imperative.

7. CONCLUSION

The chapter argues that a better way to conceptualize the nature of IPE is to focus on the relationship between politics and finance in advanced liberal capitalist states. Finance is the liberal states' postulated and sustaining principle. Political derivativeness of capitalist states and financial derivativeness of IPE reflect the underlying principles of marketplace framework: a symbiotic and mutually reinforcing relationship. Given such a symbiotic relationship, tension between the superstructure of the capitalist state and its substructure finance—with its integrating elements and transnational rootedness—is a contradiction in principle. As Plato reminds us and rightly so, "the same thing clearly cannot act or be acted upon in the same part or in relation to the same thing, at the same time, in contrary ways."[82] That is to say the relationship of advanced liberal capitalist states and their financial markets is fundamentally political. Finance is the substructure rather than a competitor. Credit organization strengthens and sustains the political superstructure

[81] Greenspan, *The Age of Turbulence*, 244.

[82] Benjamin Jowett, *The Republic of Plato*, transl. with Introduction by Benjamin Jowett, 2nd ed., revised and corrected (Oxford: The Clarendon Press, 1881), 124.

(domestic and international). Thus, the liberal state cannot be separated from its means of organization in the same way society cannot be divorced from political process.[83]

Pragmatic regulatory coordination is the means by which the political system and its financial structures are kept together. The marketplace framework fails when the rule of politics (politics-rule) becomes the accepted order. The same happens when the rule of markets (or markets-rule) becomes the accepted order. The success of the marketplace framework depends on upholding the trust and confidence embedded in politics and finance under all circumstances. Confidence—that the priests of the temple of finance would, in prosperity or in adversity, maintain adequate reserves to protect public and private interests—gives the financial and political systems what Senator Aldrich called "impregnable strength."[84] Confidence in how the financial system is managed is the key to unlocking the potentials of the liberal political economy. The marketplace framework works well when confidence is optimal. The marketplace relation is a social contract. Politics and finance are its pillars and productive economy its result. Pragmatic regulatory coordination is its fundamental element.

To appreciate the nature of the marketplace framework (marked by the mystery of finance, formal property rights system, assets representation, and pragmatic regulatory coordination), one needs to understand the nature of pluralist representative democracy. The core of this system of governance is inherent in *representation*. The power in asset representation is similar to the unnoticed, yet effective power from represented people to

[83] For details on inseparability of society and politics, see Rousseau, *The Social Contract and Other Later Political Writings*; Kenneth Waltz, Waltz, *Man, the State, and War: A Theoretical Analysis* (New York and London: Columbia University Press, 1959), 5.

[84] *An Address by Senator Nelson W. Aldrich*, 15.

elected representatives. That kind of power—valuable and transferrable—is the potential power derived from primary resources, which like the power transferred from the people, is where effective power resides. On the other hand, the absence of potential power in unrepresentative system of governance is comparable to the lack of power in undocumented property. Both are in their natural state of being.

That is to say liberal democratic capitalist states *design* policies and programs that are representative of the interests/values of their pluralist electorates and reasonably resolve conflicts among competing groups.[85] This is achieved through rule-based asset representational systems (codifying, guaranteeing, and enforcing property rights) in which market-based policy preferences shape political processes and outcome. Formal property rights system broadens the democratic ownership of market institutions through the buying and selling of percentages of equities and shares. Active participation of ordinary citizens in the exchange process is the foundation of the liberal market system. Participation increases ownership stakes in the state through the portfolio shares they own. Using the marketplace relations as a conceptual framework, we can reveal its long-standing existence by examining the two advanced liberal capitalist states: U.K. and U.S.

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[85] Schneider and Ingram, *Policy Design for Democracy*, 13.

CHAPTER 5

THE MARKETPLACE FRAMEWORK IN HISTORICAL PERSPECTIVES

> The British financiers run their business quite independent of politics, and, if we attempt to interfere, they naturally consider that we come under some obligation. If they do some particular thing, either in granting or withholding a loan, to oblige the Foreign Office, then, of course, we come under some obligation, and I do not think that it is a desirable system. It is much better that we should *leave* them to deal with these matters of loans. I do not say that there are no cases in which loans have a *political character* and in which financiers come to the Foreign Office and ask if there is any objection to them. But generally speaking, and especially in South America, these are things in which the Foreign Office does not interfere.
>
> –Sir Edward Grey[1]

> I have labored to build up such relations of confidence between the United States and the money markets of Europe that capital from there could be secured in large sums for our needs, and here is a threatened disaster that will put an end to our borrowing.
>
> –John P. Morgan[2]

1. INTRODUCTION

These epigraphs capture the essence of the marketplace framework in its historical context. The one by Sir Edward Grey—the British Foreign Secretary with the longest uninterrupted tenure—highlights pragmatic regulatory coordination in practical terms. The one by John P. Morgan—undoubtedly one of the celebrated bankers of all times—

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[1] Quoted in Herbert Feis, *Europe, the World's Banker 1870-1914: An Account of European Foreign Investment and the Connection of World Finance with Diplomacy Before the War*, with an Introduction by Charles P. Howland (New Haven: Yale University Press, 1930), 85 (emphasis added).

[2] This quote is part of Morgan's reaction to President Grover Cleveland's 1894 ultimatum to Britain regarding an impending trade dispute over Venezuela. For details, see George W. Edwards, *The Evolution of Finance Capitalism* (New York: Augustus M. Kelly, 1967), 165. See a shortened version of the quote in Ron Chernow, *The House of Morgan: An American Banking Dynasty and the Rise of Modern Finance* (New York: Grove Press, 1990), 73. For the ultimatum, see "President's Third Annual Message (Second Term)," December 2, 1895, available from http://millercenter.org/scripps/archive/speeches/detail/3763 (accessed March 19, 2010).

identifies the substratum of the marketplace relations, which is confidence and trust between liberal politics and finance. It illustrates the relationship between his financial empire and the governments of the U.S. and Europe by the turn of the twentieth century.[3] In brief, the two quotes provide evidence of the embedded and expedient nature of the marketplace framework by highlighting the *political character* of finance as well as the dynamism of regulatory convergence in advanced liberal capitalist economies.

Although the focus is on the U.S. and U.K., the historical analysis/interpretation begins from the emergence of the Westphalian states system. Doing so provides a broad evolutionary background for the practice of regulatory coordination. In that sense, the chapter explores political processes, de jure and de facto policy preferences, and non-territorially based regulatory coordinating practices that underpinned the evolution of financial capitalism. The historical analysis is necessary although as Keith Jenkins pointed out, "history is never for itself." History—being a synthesis of events within many disciplines—is burdened with methodological, epistemological, and ideological constraints and should, therefore, be interpreted with extra caution.[4] Nevertheless, history rewards research, for as Peter Stearns argues, it is a bit "silly" to tackle the nonexistence

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[3] For details on how U.S. political authorities related with Morgan and his banking industry, see Roberta A. Dayer, "Strange Bedfellows: J. P. Morgan & Co., Whitehall and the Wilson Administration During World War I," *Business History*, Vol. 18, Issue No. 2 (July 1976): 127-151

[4] For a postmodernist's view of history as a discipline vis-à-vis the concept of "time, evidence, cause and effect, continuity and change, and similarity and difference," see Keith Jenkins, *Re-Thinking History* (London and New York: Routledge, 1991), 16-17. Jenkins argues that history "is an ideological construct" that is continuously "re-worked and re-ordered." It is in the same sense that Walt W. Rostow warns analysts of the danger of drawing policy prescriptions from historical generalizations into "tidy laws of history." For details, see his review essay, "Beware of Historians Bearing False Analogies," *Foreign Affairs*, Vol. 66 (Spring 1988), 86. For a classic analysis of history and historiography, see Carl Becker, "Everyman His Own Historian," *American Historical Review*, Vo. 37, No. 2 (December 1931), 221-236.

of a phenomenon in history.[5] Mindful of these divergent views, my historical analysis seeks to enhance understanding of the symbiotic role of finance in "intermestic" politics.

2. THE EVOLUTIONARY PREMISE OF THE MARKETPLACE FRAMEWORK

I noted in Chapter 2 that the modern capitalist system did not emerge like a mushroom overnight; it was a "contingent product" of a particular time and space and was, in fact, characterized by overlapping centers of power, authority and allegiance. Its growth and expansion coincided with the emergence of the Westphalian state, which was territorially 'defined' and controlled by determinate political entities. Each territory was marked by political institutions and practices that regulated the daily lives of the subjects.[6] And each was a hub of social, economic, and political organization, with an absolute monarch as its embodiment. The economy was organized with the state decisively allocating public and specific goods. Comparatively, the Westphalian order was different from the feudalist system in the sense that it was more extensive and organizationally complex.[7]

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[5] Michele Micheletti, Andreas Follesdal, and Dietlind Stolle, "Introduction," in *Politics, Products, and Markets: Exploring Political Consumerism Past and Present*, ed. Michele Micheletti, Andreas Follesdal, and Dietlind Stolle (New Brunswick, NJ: Transaction Publishers, 2004): ix-xxxvi. See also Peter N. Stearns, *Consumerism in World History: The Global Transformation of Desire* (London and New York: Routledge, 2001), 1. For a similar view on historical knowledge and skepticism of truth in history and politics, see Joyce Appleby, Lynn Hunt, and Margaret Jacob, *Telling the Truth About History* (New York: W. W. Norton & Company, 1994).

[6] See Ferguson, "The Crisis of the State in a Globalizing World," 5-8; Ferguson and Mansbach, *Remapping Global Politics*, 1-2, (see fn.2, p. 2); Yale H. Ferguson, "Hedley Bull's *The Anarchical Society* Revisited: States or Polities in Global Politics," in *International Society and the Development of International Relations Theory*, ed. B. A. Roberson (London and Washington: Pinter, 1998): 184-209; Ferguson and Jones, eds., *Political Space: Frontiers of Change and Governance in a Globalizing World*; Sylvan, "Periphery, Centre, Mass: Alternative Histories of Europe's Role in Globalization."

[7] See Moore, *Social Origins of Dictatorship and Democracy*.

For such a complex system to function well, the concept of division of labor and specialization became necessary. In that scheme of things, political authorities provided physical security and regulated the economy by enforcing commercial laws and property rights. This arrangement guaranteed innovation, ownership, and security for private investment while ensuring regular sources of funds for state actors to allocate resources, supply specific public goods and undertake territorial defense and expansion.[8] The victorious powers in those wars were those that mobilized and sustained large sources of credit. They did so through a combination of taxation, bond-selling, money borrowing as well as through short-term and long-term credit negotiations with merchants, bankers, private financial institutions, and groups of financiers/contractors. In so doing, credit organization underpinned the structural and relational power of political entities that protected and nurtured their financial agencies and structures. Financial agencies and institutions, in turn, organized their respective credit systems in ways that 'responsibly' allocated values and reinforced the sinews of their states.

We can see from this context that the role of finance in modern world politics dates back to the emergence and consolidation of the states system. As the European wars of conquest—what Paul Kennedy refers to as the Great Powers' "habit of settling rivalries"—and the "the great wheel of circulation" became inextricably intertwined in interstate relations, the role of credit became increasingly crucial. In effect, governments' ability to generate and spend large sums of credit served as "a bellows" that fanned

[8] Benno Teschke, "Theorizing the Westphalian System of States: International Relations from Absolutism to Capitalism," *European Journal of International Relations*, Vol. 8, No. 1 (2002): 5-48; Larry Neal, *The Rise of Financial Capitalism: International Capital Markets in the Age of Reason* (Cambridge and New York: Cambridge University Press, 1990), 5-19; William Wiseley, *A Tool of Power: The Political History of Money* (New York and London: John Wiley and Sons, 1977), 30-36.

economic growth, "the development of western capitalism and the nation-state itself."[9] Thus, finance—being the sinews of states, "the nerves of war" and the great instrument of exchange—was the cementing agent of the state and interstate system. These interactive processes that led to the emergence of the mercantilist state—the inclusive, powerful and sufficient state to whose purpose territorially structured policies were directed.[10] In fact, the very nature of finance—being the great instrument of exchange and the nerves of war—makes it a fierce master a and humble servant across political realms.

The increasing role of credit in the states system led to a "financial revolution"—being the first time fiduciary money was used—in the eighteenth century, with maritime cities and towns emerging fully as holy centers of finance, trade, and governance.[11] It was in those centers that a concentration of merchants, intellectuals and rulers developed the distinctive enterprise that centered on "the flows of information, credit, merchandise, ideas, and power contained within their established institutional networks."[12] In effect, the logical relationship between finance and coercion in those centers underpinned the development of the state and the states system. Tilly describes this logic of relation in his

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[9] Kennedy, *The Rise and Fall of the Great Powers*, 77-78. On "the wheel of circulation," see Smith, *The Wealth of Nations,* 314, 317, 322. See also Fernand Braudel, *The Wheels of Commerce: Civilization and Capitalism, 15th-18th Century, Volume II* (Cambridge: Harper & Row Publishers, 1979); Russell R. Menard, "The Great Wheel of Circulation" (Review Essay), *Reviews in American History*, Vol. 6, No. 4 (December 1978), 435.

[10] Tilly, *Coercion, Capital, and European States*, 5-17; Edwards, *The Evolution of Finance Capitalism*, 9. It is important to note that not all scholars think of this historical relationship between politics and finance as a settled argument. As Gilpin pointed out, "the historical relationship of state and market is … an intense scholarly controversy. Whether each developed autonomously, the market gave rise to the state, or the state to the market are important historical issues" that have not been resolved. See Gilpin, *The Political Economy of International Relations*, 10, fn. 1).

[11] Langley, *World Financial Orders: An Historical International Political Economy*, 10, 32; Benjamin J. Cohen, *The End of Geography* (Ithaca and London: Cornell University Press, 1998), 14-15.

[12] Randall D. Germain, *The International Organization of Credit,* 15.

Coercion, Capital, and European States best: "Behind the changing geography of cities and states operated the dynamics of capital (whose preferred sphere was cities) and of coercion (which crystallized especially in states)."[13]

What this means in our context is that credit organization intertwined with the emergence and development of maritime cities, the state, war, and the state system in such a way that the concentration of material capabilities in the centers of finance meant centralization of force in the nation-states in which those centers were located. In effect, one cannot comprehend the authority and power of the state without examining the power and influence of finance. They have cognate origin with shared purpose and function. That exactly is what the marketplace framework is about: i.e., the state and the interstate system cannot be logically governed without the structural and relational power of finance. In brief, finance not only helped consolidate the European system of states, it underpinned the system's diffusion (with all of its contradictions and inconsistencies) on the waves of imperialism and diplomacy into the rest of the world.[14]

This symbiotic relationship between the maritime trading centers—the hub of world finance—and the states (to which they belong) was first evident in the relationship between seventeenth century Amsterdam and The Netherlands. Amsterdam's status as a

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[13] As Tilly explains, "The story [i.e., the theme of his work] concerns capital and coercion. It recounts the ways that the wielders of coercion, who played the major part in the creation of national states, drew for their own purposes on the manipulators of capital, whose activities generated cities." See Tilly, *Coercion, Capital, and European States*, 5, 16, 17. John Stuart Mill termed the dominance of finance in that relationship as "the tyranny of capital." See *The Letters of John Stuart Mill*, edited with an Introduction by Hugh S. R. Elliot, with a Note on Mill's Private Life by Mary Taylor (London: Longmans), 1910), 22. For other references and usage of the phrase, see Wiseley, *A Tool of Power: The Political Economy of Money*, 31-36; Waltz, *Man, the State, and War*, 92; Holsti, *The State, War, and the State of War*, 3-4.

[14] See Hilferding, *Finance Capital*; Langer, *The Diplomacy of Imperialism*. See also Findlay, "Globalization and the European Economy: Medieval Origins of the Industrial Revolution," 32-63; Kevin H. O'Rourke, "Europe and the Causes of Globalization, 1790 to 2000," 65-86.

center of world financial order reinforced the preeminence of The Netherlands as a world power.[15] By the end of the eighteenth century, Britain perfected the Dutch system and developed an advanced form of international credit organization based on the gold standard. With the peace provided by the Concert of Europe and a superior naval and technological capacity in place, Britain replaced The Netherlands as the world's leading industrial and financial power.[16] Its financial capital was the "quickest and fastest to move," and for over a century, Britain was the financial hegemon anchoring the world economy by providing it with liquidity. That hegemony was built on the financial structures provided by private credit institutions and agencies located in what Lord Lansdowne, the British Foreign Secretary (1900-1905), called "that great organism which we are in the habit of describing as the City [of London]."[17]

It is evident from the foregoing that the need for political authorities—beginning from the emergence of the states system—to identify, nurture and embed structures and functions of finance in their respective nation-states cannot be overstated. Finance was fundamental in the emergence and consolidation of the state and the states system. It was also central in the rise and fall of great powers, including the Dutch and British empires. A broad examination of the British financial order from the Industrial Revolution through

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[15] Neal, *The Rise of Financial Capitalism*, 6-9; Tilly, *Coercion, Capital, and European States*, 19; Langley, *World Financial Orders*, 44.

[16] See Langley, *World Financial Orders*; Levine, "Financial Development and Economic Growth," 688; Feis, *Europe the World's Banker*, 4

[17] Quoted in Feis, *Europe, the World's Banker*, 92. The "City" in reference is what is known as the City of London--the financial hub England, the equivalent of Wall Street. For an example of the role financiers and private bankers in British politics in the fist half of the nineteenth century, see Niall Ferguson, *The House of Rothschild: Money's Prophets 1798-1848* (New York: Viking, 1998); Langley, *World Financial Orders*, 54, 63-65.

to the end of World War II is the theme of the section that follows. Emphasis is placed on how the country's financial system (shaped by its political thought, institutions, and practices) reinforced the development of the British state-society as well as Britain's leading role in transcontinental networks of production, exchange, and the "embedding of nation-state and the states system" (Cerny).

3. FINANCEIAL GOVERNANCE IN BRITAIN

I. National Debt, Stock Exchanges, and the Bank of England

Britain's manufacturing and commercial life from the Industrial Revolution through the Napoleonic Wars was financed with capital from individual entrepreneurs and private commercial banks. A number of those banks developed rapidly throughout the period in reference. They funded the nation's industrial and trading activities by issuing their own private promissory notes. The Bank of England (also known as "The Old Lady of Threadneedle Street") assumed a significant role in the country's financial markets only when the Napoleonic Wars started. One of the reasons for the shift was the influx of capital from continental Europe into England. As a result of Napoleonic expansionism, major European currencies collapsed, particularly in Amsterdam, the center of the Dutch financial order. The relative peace and security in Britain attracted that flow of capital.

Despite the somewhat active role of the central bank, private banks continued to dominate credit organization and the issuing of bills in the country until Parliament enacted the Bank Charter Act in 1844, a statute that gave the Bank of England exclusive rights to issue and manage uniform bank notes.[18] The monopoly of issuing bank notes is a major mark of pragmatic regulation in that it provided stable and dependable monetary system for the British state and market institutions. That exclusive monopoly unified the country, strengthened the political system, and harmonized market activities. Business transactions were carried out in the same currency, which made convertibility of financial instruments swift and easy. Clearing-house payments were smoothed out as the central bank held the same reserve currency for the nation's financial institutions. In brief, a stable, reliable reserve currency is a feature of the marketplace framework in the sense that it harmonizes political goals and market processes.

Before the Bank Charter Act, the Bank of England was a "feeble organization," which only strengthened government treasuries.[19] The need to reinforce it with regulatory authority stemmed from the ever growing interconnectedness of private finance and state-centric activities within and beyond Britain, particularly as a result of the influx of capital from continental Europe. Two related reasons account for that pragmatic regulatory shift. First, it became imperative for the British government to put in place structural measures that would ensured market integrity and confidence in the system for both domestic and external investors. Generating investors' confidence and guaranteeing depositors' trust is a true mark of the marketplace framework. It enables the confidence of the investing

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[18] *Bank Charter (or Bank of England) Act of 1844: Anno Septimo & Octavo and Victoriae Reginae* CAP XXXII, July 9, 1844, available from http://www.ledr.com/bank_act/bca_01.pdf (accessed March 16, 2010). For the full text, see http://www.ledr.com/bank_act/1844032.htm (accessed March 16, 2010). See also Edwards, *The Evolution of Finance Capitalism*, 16.

[19] Edwards, *The Evolution of Finance Capitalism*, 10.

public to synchronize with the confidence of the general public. More importantly, it harmonizes public welfare with private incentives for the common good.

Second, the main source of security investment throughout the period under review was the national debt, which was traded on private stock exchanges. The central bank's regulatory power was to ensure efficient coordination of government finance on the exchanges. Like other major states, Britain's wars of expansion and defense were carried out with public borrowing on said exchanges.[20] What the Bank Charter Act did, in effect, was that it strengthened the central bank's management of the national treasury via the stock exchanges. Such is a perfect feature of the marketplace framework in that the increasing convergence of state and financial market activities in the realm of national debt—a convergence that hinged on effective credit organization—necessitated the law. In that sense, the law benefited both the state and the private financial sector.

In fact, the London securities markets, being the core of the British financial system, predates the Revolution of 1688. That was the time the 'stocks' of market institutions such as the Royal African Company, East India Company and the Hudson's Bay Company were bought and sold through direct contacts between brokers and dealers.[21] The effective development of those mercantile markets from buying and selling of 'goods' to credible stock exchanges for raising capital through purchase of debts and

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[20] For instance, the Britain's public debt increased from £13,000,000 in 1709 to £900,000,000 at the end of the Napoleonic Wars. This includes about £220 million incurred in the American Revolutionary War, which the government borrowed at a 3 percent interest rate with £7.33 million annual repayment. For details, see Kennedy, *The Rise and Fall of Great Powers*, 84. On Britain's public debt from 1793-1815, see Ferguson, *The House of Rothschild*, 84.

[21] S. R. Cope, "The Stock Exchange Revisited: A New Look at the Market in Securities in London in the Eighteenth Century," *Economica*, *New Series*, Vol. 45, No. 177 (February, 1978), 2.

transfer of securities began in 1773. This was the year brokers decided the markets should be called the London Stock Exchange (LSE).[22]

All things considered, location of the LSE in terms of structural relational activities with political institutions—what Geoffrey Ingham calls the "City-Bank of England-Treasury nexus"—illuminates the marketplace relation. The LSE and the Bank of England were situated on Threadneedle Street until 2004 when the former was relocated on Paternoster Square near St. Paul's Cathedral. The LSE received its legal basis of existence from Parliament in 1801/02, early into the Napoleonic Wars. The political importance of the LSE grew over time, with increased trade in government debt and corporate securities. So much confidence and trust it had assumed that state actors considered it unnecessary to provide additional legal basis until 1867 when its status was reinforced with a statutory amendment. That political trust allowed the LSE to establish a privileged group of broker-dealers who eventually gained tremendous monopoly in the conduct of security dealings.[23]

Three broad marketplace relations are decipherable from interactions between the LSE and British political authorities. First, the non-renewable deed of settlement (until 1867) speaks to the symbiosis of confidence and trust between advanced liberal politics and finance. Because of that the LSE was left to self-regulate.[24] Second, the Treasury-

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[22] Edwards, *The Evolution of Finance Capitalism*, 11; Ronald Michie, "London and New York Stock Exchanges, 1850-1914," *The Journal of Economic History*, Vol. 46, No. 1 (March 1986), 172.

[23] See Edwards, *The Evolution of Finance Capitalism*, 11. On "City-Bank of England-Treasury nexus," see reference in Langley, *World Financial Orders*, 54, 63.

[24] Feis, *Europe the World's Banker*, 83. See also Edward Stringham, "The Emergence of London Stock Exchange as a Self-Policing Club," *Journal of Private Enterprise*, Vol. 17, No. 2 (Spring 2002).

LSE-Bank of England nexus was important, given that government debt was the largest security traded on the LSE. Such is an irrefutable evidence of the political character of finance. Third, relations between important financial market authorities and political actors, including the constitutional monarchs, were close. So vital were such relations that in 1810, "a special messenger" informed the King and the Prince of Wales about the death of Abraham Goldsmid, the King of the LSE. In 1811, Benjamin Walsh, a broker and Member of Parliament was expelled from the House of Commons for perpetrating an organized fraud on the LSE. A retired navy officer and politician, Cochrane Johnstone, was deprived of his parliamentary standing in 1814 because he circulated a false rumor about Napoleon's death with the intention to push a fraudulent stock market deal.[25]

In essence, such close connections between and LSE entrepreneurs and political authorities do not reflect tensile relationships; they rather reveal the dynamism of regulatory coordination. The LSE was vital to state authorities because public debt was traded on it. That explains why Parliament established it as a monopoly. A monopolistic economic institution serves the interests of politics and markets. As I argued earlier, a monopolistic or an oligopolistic market is a reflection of the *practical consequences* of finance. As it were, the Concert of Europe fortified the LSE's monopoly.

II. Designating the Liberal Economy as Self-Regulating Realm

The Concert of Europe marked the effective beginning of liberalism in England, with Parliament becoming "fairly representative of the popular will."[26] Within that society-state relation, public institutions and economic matters moved from the realm of private

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[25] Edwards, *The Evolution of Finance Capitalism*, 11; Ferguson, *House of Rothschild*, 52, 85.

[26] Edwards, *The Evolution of Finance Capitalism*, 12.

affairs to social welfare. As Weber pointed out, the bureaucratic "democratization of the franchise" backed by the emerging machine of finance "had arisen in the Liberal party in connection with Gladstone's ascent to power."[27] Gladstone's liberal governing philosophy was particularly evident in the Joint Company Act of 1844, the benchmark legislation he helped design as chairman of the Select Committee on Joint Stock Companies. That piece of legislation marked the effective beginning of British governments' flexible principles toward market institutions. It required simple registration for joint stock companies. That made incorporation available throughout the country. Eleven years after its enactment Parliament passed a "limited" liability incorporation law. In effect, those laws "divorced" the British economy—trade and finance—from political interference as a self-regulating realm. The self-regulating concept was enforced in the foreign policy realm as well.[28]

As I noted in the Introduction, effective *designation* of the economy as a self-regulating sphere is the peculiar characteristic of advanced capitalist states. Legislative designs in these states are never disordered thoughts; they are a means by which political interests are served. Financial governance in those *unnecessarily separates* the temple of finance from politics. That is because finance *is the means specific* to the liberal state. In fact, reflections on Grey's account of the British government's policy regarding British financiers validates this point. His statement shows that the interests of politics and finance, established via "limited" liability companies, are never contradictory in purpose. Indeed, as a U.S. judge observed in 1860, "A corporation is a creature existing, not by

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[27] See Weber, "Politics as a Vocation," 16.

[28] L. C. B. Gower, "Some Contrasts Between British and American Corporation Law," *Harvard Law Review*, Vol. 69, No. 8 (June 1956), 1371; Langley, *World Financial Orders*, 52.

contract; but … [it] is created or authorized by statute; and its rights, and even modes of action, may be, and generally are, defined and marked out by statute; and when they are, they cannot be changed, even by the contracts of the corporators."[29] In the context of this quote, I argue that markets are political derivatives because they are created, defined, and authorized by statutory instruments for specific purposes and functions. And their terms and purposes can only be changed by law. This is a sufficient evidence that finance, and for that matter the marketplace framework, is a legal mystery.

This brings us to a key argument of the dissertation, which is about the centrality of the judicial arm of the liberal state in pragmatic regulatory coordination. It is also reminds of Chief Justice Hughes' statement on judges' authoritative interpretation of the import of a Constitution.[30] To the extent that the legal system of a hyper-liberal state is concerned, politics and financial markets are cognate institutions. Each exists for the interest and of the other. Politics is the superstructure, finance is the "infrastructure of infrastructure" (Cerny). As such, both cannot be in tension with each other; they can only have a symbiotic relation. In that sense, the idea of a tension existing between states and markets (financial markets included) is an advanced liberal façade designed for reorganizing the world economy.

The marketplace framework, therefore, seeks to *reunite* the cognateness of liberal politics and finance for what they truly are: symbiotic in origin/function. The synergetic relation evident in the firm monetary foundation the LSE received when the Bank of England resumed specie payment in 1821—a payments system that made England the

[29] Quoted in Gower, "Some Contrasts Between British and American Corporation Law," 1372.

[30] Quoted in Rehnquist, "The Notion of a Living Constitution," 698.

first industrialized state to switch from a silver standard to the gold standard of payment. The benefits went beyond the political symbolism of being the first state to do so; the LSE and its listed companies gained in material terms in the sense that market institutions and agencies turned to profit whenever the central bank resumed specie payment.

The marketplace relation is also evident in the democratic model of corporations. Corporations are molded on the principles of representative governance, with each shareholder having a vote in the management of the corporation. Management is itself is *separated* from ownership of capital in the same manner the liberal state is *separated* from the economy. To check abuse of managerial powers, shareholders elect board of directors at annual meetings to regulate companies. In theory, the board of a company is invested with appointment, disciplinary, and removal powers. It is also supposed to have the power to constrain executive earnings.[31] But these are not necessarily true in practice, for as Mark Mizruchi pointed out, the management of a corporation does not only report to the board of directors; it also *selects* the board members. In that sense, the power of control in a corporation does not usually rest with the board, it rests with management.[32] Although a sense of "tension" may seem to exist between management and the board, but the reality is different because through the selection process,

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[31] Gower, "Some Contrasts Between British and American Corporation Law," 1383. For a recent analysis of separation of ownership from control of corporations, see Stiglitz, "Credit Markets and the Control of Capital."

[32] Quoted in Mark S. Mizruchi, "Who Controls Whom? An Examination of the Relation between Management and Boards of Directors in Large American Corporations," *Academy of Management Review*, Vol. 8, No. 3 (1988): 426-435, see p. 426. For a recent analysis of "tension" between shareholders and board of directors, see Jennifer Hill, "The Shifting Balance of Power between Shareholders and the Board: News Corp's Exodus to Delaware and Other Antipodean Tales," *Vanderbilt Law & Economic Research Paper No. 08-06* (January 1, 2008).

management controls the board of directors, and not the other way round. The tension terminology only provides ideological frame of difference. This business practice—which dates to early nineteenth century England—is a marketplace experience because it enhances the relative efficiency of both political institutions and business organizations in rather subtle ways.

As indicated earlier, the rise of liberalism (anchored by the Concert of Europe) enhanced England's foreign investment. Rapid economic growth opened investment prospects in shipping, mining, railroad construction, and land development on mainland Europe and in South America. London financial market institutions and the British state both benefited from those developments. For instance, the U.S. and South American countries received large sums in British investments in railroads, turnpikes, and other public projects. British financial institutions invested in those government bonds and corporate securities. As early as 1818, the Rothschild secured the first "unguaranteed foreign-government" loan to appear on the London financial markets for the government of Prussia. In 1824, the Ricardos floated a loan to Greece to liberate itself from Turkish control. Records, however, show that a greater percentage of the Greek loan was not used for its intended purpose; it was rather used to reward the loan negotiators.

The marketplace relation in these contexts is the embedded support the British state provided its investment institutions, support that helped sustain the London financial order. Nothing reveals better the nature of that kind of support than Grey's statement in the beginning of this chapter. A few of those official policies are examined below.

III. Finance and British Foreign Investments

British capital investments in foreign countries generated additional sustenance to trade. As those investments created competition abroad, the country's non-financial interests saw no basis to criticize foreign investments. As Herbert Feis pointed out, there was "much less of that undertone of criticism of foreign investment on economic grounds by commercial and industrial circles."[33] And there was almost no official intervention, except where British national interests were threatened. Feis observes in that regard:

> Numerous official documents bear witness to the reluctance of the government to … check an investment operation …. Such was the general tradition and official policy. The government tended—as far as ordinary practice went—to *treat* the financial institutions as a separate independent power, rather than as a subordinate one (emphasis added).[34]

This passage reflects the policy tone and themes expressed in Grey's statement. The government "treated" financial market institutions as independent entities, for at least two additional reasons. First, the policy position was consistent with British political thought and life, which held in high regard the pursuit of private enterprise. Second, the financial and monetary pillars of the London-centered governance structure means both public and private authority hinged on the LSE-Bank of England-Treasury network. Political and financial relations were designed to lack fixed, definitive principles. The system worked well because of regulatory coordination—the postulating and sustaining principle of advanced liberal capitalism. Pragmatic regulatory coordination is the politically-

[33] Feis, *Europe the World's Banker*, 84.

[34] Feis, *Europe the World's Banker*, 85.

engineered process of coalescing private financial interests with public interests in shifting circumstances. Expediency is the basis of the liberal market economy.[35]

In sum, large scale accumulation of capital in nineteenth century Britain was possible because of the country's adherence to the marketplace framework. A relative decline in government taxation vis-à-vis a rise in national income contributed to such capital buildup. For instance, taxation accounted for 9 percent of gross national income in 1815. This percentage point dropped to 5.5 in 1843.[36] The reduction was compensated for by increased revenue in securities investments in foreign countries. That gave the marketplace relations a dynamic balance in the sense that the reduction helped market institutions in general while furthering government's social policy goals. Many of the foreign investments, however, were not without speculative crises. The next section examines a few of those crises, with a focus on how the British state and its financial market institutions managed them.

IV. Speculative Crises and Political Responses

The earliest crises in British securities markets resulted from speculative loans that credit institutions floated on behalf of foreign governments. One such loan was meant for draining the Red Sea to retrieve the supposed gold jewels that ancient Egyptians lost in their biblical passage after the Israelites. Another "unsound" loan was designed for exploiting immense, but "unknown" minerals in Ireland. The first major crisis resulting from such activities occurred in 1825. Security prices collapsed and a large number of

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[35] See Parris, "The Nineteenth-Century Revolution in Government," 36.

[36] See Edwards, *The Evolution of Finance Capitalism*, 20.

provincial banks failed. The total loss was about £16,000,000. Another crisis involving domestic railway securities occurred in 1846. The cost was about £100,000,000.[37]

These crises generated public resentments and extensive criticisms. The banker capitalists were the main targets, with their speculating firms described as "bubbles and delusions." One such criticism came from William Cobbett, a journalist who wrote:

> Such indeed, is the operation of all great capitals of credit which enable the capitalist by means of banks to multiply the natural power of his stocks even three and fourfold; to grasp, monopolize and control everything … Large capitals and credit … have a tendency to monopolization and to form a kind of bourgeois and upstart aristocracy with all the faults of the former and without any of its virtues.[38]

Cobbett's views were later reinforced by Gilbert K. Chesterton, a British writer, political thinker and Christian apologist. He wrote remorsefully about the capitalist:

> He [the capitalist] would have been as ready as any merchant or trader to face the fact that man, as God has made him, must make money. But he had a vivid sense that the money must be as solid and honest as the corn and fruit for which it stood, that it must be closely in touch with the realities that is represented; and he waged a furious war on all those intricate and sometimes imaginary processes of debts and shares and promises and percentages which make the world of wealth today a world at the worst unreal and at the best unseen …. But what he was at once predicting and denouncing, like a small cloud that had not yet become a universal fog, was that vast *legal fiction* which we call finance. In any case, against a world in which such *financial mysteries* were multiplying every day, in which machinery was everywhere on the march, and the new towns spreading with the swiftness of a landslide … against the whole great crawling labyrinth of the modern state which is almost one with the modern city (emphasis added).[39]

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[37] See Edwards, *The Evolution of Finance Capitalism*, 21-22.

[38] See this quote in Edwards, *The Evolution of Finance Capitalism*, 23. On "bubbles and delusions," see Bishop C. Hunt, "The Joint-Stock Company in England, 1830-1844," *The Journal of Political Economy*, Vol. 43, No. 3 (June 1935), 332.

[39] Ripley, *Main Street and Wall Street*, v-vi; Edwards, *The Evolution of Finance Capitalism*, 23.

Apart from economic burden and social injuries inherent in those crises, two important points can be gleaned from these extracts. The first is about the nature of finance: a vast "legal fiction" based on percentages of shares, debts, and promise. The second entails the structured relation between finance and the state: the central theme of the dissertation.

Critics were particularly against the foreign loans and the hard they cause British taxpayers. Notwithstanding those losses and scathing criticisms, the British government made no far-reaching effort to regulate the financial industry. As George Edwards notes, the laissez-faire doctrine of classical philosophy was so pervasive to allow any form of governmental control.[40] Feis explains that governing philosophy concisely:

> The whole nature of the relationships between finance and government in Great Britain displayed those marks which have been considered characteristic of British political life and institutions; a regard for private interest and initiative, a dislike for legislation and regulatory routine, the creation of a code of relationship of action, but withal the easy adaptation of action to circumstance, even in violation of code.[41]

The key phrase in this quote is *easy adaptation of action to circumstance, even in violation of codes*. It reveals the nature of the marketplace framework succinctly: pragmatic regulatory coordination of finance and politics.

Faced with increasing speculative concerns, the British government saw the need to adapt the laissez-faire approach to changing circumstances. By mid-nineteenth century,

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[40] Edwards, *The Evolution of Finance Capitalism*, 36. See also Hunt, "The Joint-Stock Company in England," 331; Lance Davis and Larry Neal, "Micro Rules and Macro Outcomes: The Impact of Micro Structure on the Efficiency of Security Exchanges, London, New York, and Paris, 1800-1914," *The American Economic Review*, Vol. 88, No. 2 (May, 1998), 43; Feis, *Europe the World's Banker*, 83.

[41] Feis, *Europe, the World's Banker*, 117.

there was a recognition for some form of pragmatic regulatory mechanism to safeguard public trust and confidence. That happened in the area of financial reporting.[42]

V. Regulatory Reform: Legitimizing Market Information

The most comprehensive attempt to regulate speculative practices on the LSE took place in 1844. As indicated earlier, this was the year the Select Committee on Joint Stock Companies submitted its report to Parliament, emphasizing that "periodical accounts, if honestly made and fairly audited, cannot fail to *excite attention* to the real state of concern; and by means of improved remedies, parties to mismanagement may be made more amenable for acts of fraud" (emphasis added).[43] An equally important part reads as follows: "the imposition of statutory regulations and prohibitions calculated not merely to put a stop to the activities of the wrong-doer but to place quite intolerable fetters upon private business."[44] Placing unbearable shackles on market swindlers is the central theme in this extract. Such was necessary not only to stop offending market participants, but to make private business thrive, thereby, generating confidence and trust in the system. The state would ensure market institutions responsibly invent value for factors of production. To *excite attention to the real state of concern* implies exhibition of political commitment toward managing social tension, as that would guarantee confidence and trust in investing

[42] R. H. Parker, "Regulating British Corporate Financial Reporting in the Late Nineteenth Century," *Accounting, Business and Financial History*, Vol. 1, Issue 1 (October 1990), 54.

[43] Quoted in Edwards, *The Evolution of Finance Capitalism*, 25. See also A. C. Storrar and K. C. Pratt, "Accountability vs. Privacy, 1844-1907: The Coming of the Private Company," *Accounting, Business and Financial History*, Vol. 10, Issue No. 3 (November 2000), 263; Josephine Maltby, "'A Sort of Guide, Philosopher, and Friend': The Rise of the Professional Auditor in Britain," *Accounting, Business and Financial History*, Vol. 9, Issue No. 1 (March 1999), 33.

[44] Quoted in Edwards, *The Evolution of Finance Capitalism*, 25. See also Arthur M. Whiteside, "Legislation Relating to Public Companies," *Oregon Law Review*, Vol. VI. No. 2 (Feb. 1927): 93-107.

public. In fact, pragmatic regulatory coordination is about managing social expectation than it is about solving actual problems. Indeed, political socialization through symbiotic legislation and market-based exchange system guarantees static equilibrium.

The Select Committee reports formed the basis of the Companies Act of 1844, which required registration of company prospectuses. It laid the foundation of protective principles for corporate investors by requesting companies to provide the truth about securities they offered for sale.[45] The Act marked the effective beginning of regulatory coordination of securities investments in Britain and beyond.[46] Its information disclosure requirement provided investors with a means to inform themselves through publicly filed documents as to the fairness of proposed securities and their promise of equitable return. It must be noted that the fair information disclosure section of said Companies Act was the key element of the U.S. Securities Act of 1933. We shall return to this point later.

It is important to highlight Gladstone's contribution to the design of said statutory regulation. His contribution, however, was not surprising if one recalls his statement (see chapter 3) about finance being the central stomach of the state. There is little doubt his understanding of the fundamentals of finance vis-à-vis the states system, held sway in the committee's final recommendations. As it turned out, the Companies Act of 1844 was the single most important symbol of nineteenth century British marketplace relations. Its information disclosure requirement may seem to constitute tension between the British government and market institutions, but that is not the case. It rather strengthened their

[45] Gower, "Some Contrasts Between British and American Corporation Law," 1373; Mary Poovey, "Writing about Finance in Victorian England: Disclosure and Secrecy in the Culture of Investment," *Victorian Studies*, Vol. 45, Issue No. 1 (Autumn 2002), 28.

[46] Leonard W. Hein, "The Auditor and the British Companies Act," *The Accounting Review*, Vol. 38, No. 3 (July 1963), 508.

relations and enhanced their relative efficiency. It generated investors' confidence and guaranteed depositors' trust in the political as well as financial market institutions. In essence, that Act laid the foundation for "divorce" between politics and economics, which of course, is its enduring legacy for modern form of public corporations.

The impact of the Act on British political economy was extensive. The period from 1840s through early 1890s—the Victorian Age—was the era of triumph for British economy in general, and its financial sector, in particular. The nation's industries were powered by steam and its manufactured goods found markets in all parts of the world. Britain was not only the worlds' manufacturer, it was its financier and banker, too. In fact, the era witnessed development and growth of financial institutions, including investment banks, overseas subsidiaries, commercial banks, and private investment trusts. The relationship between the Bank of England and the financial industry was passive and liberal in tone. The banks granted loans with no regard to whether companies' securities were listed on the LSE. They did so as long as the values of the firms' securities could somehow be ascertained.[47] This practice reflects marketplace relations because of the veiled guarantee by the central bank to manage systemic risks. This was a relationship shaped by confidence and public trust to enable financial institutions to create credit instruments so necessary for organizing the structures of the British political system.

Such passive, yet reciprocal relationship reinforced the passage of the Companies Act of 1862, which allowed large commercial banks to absorb many of the private banks. In brief, the 1862 Act facilitated formation of incorporated banks, evidenced by the fact

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[47] Quoted in Edwards, *The Evolution of Finance Capitalism*, 29.

that by the end of the century, a large number of provincial and private banks (many of which financed individual capitalists during the early period of the Industrial Revolution) were absorbed or acquired by large commercial and investment banks. The newly established joint stock banks extended credit as well as participated actively on the LSE. Many of them opened branches and syndicates in Europe, Latin America, the Far and Near East.[48] Investment banking during this period was largely impersonal, as securities were widely distributed on the LSE. Such increased the social and political powers of commercial and investment bankers who, in turn, influenced the national body politics in diverse ways, including purchasing parliamentary seats. That is regulatory coordination of politics and finance shaping each other in the realm of liberal governance.

With all of these developments—the Bank of England assuming monopoly of issuing bank notes, the LSE assuming ever-increasing role in the financial industry, big banks absorbing provincial banks and making concentration of investment banking possible, and growth and expansion of investment trusts—London truly became the financial capital of the world.[49] As noted earlier, the City's emergence as a clearing-house and safe haven for European bullion and financial capital effectively began during the Napoleonic Wars and lasted through the revolutionary movements of 1848. The inflow of capital was evident in the volume of securities traded on the LSE. For instance, about £2,000,000,000 of the total listed securities in 1875 were held abroad.[50]

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[48] Edwards, *The Evolution of Finance Capitalism*, 30; William N. Goetzmann and Andrey D. Ukhov, "British Investment Overseas 1870-1913: A Modern Portfolio Theory Approach," National Bureau of Economic Research, Working Paper 11266, available from http://www.nber.org/papers/w11266.

[49] Feis, *Europe the World's Banker*, 117; Langley, *World Financial Orders*, 48-59.

[50] Edwards, *The Evolution of Finance Capitalism*, 34.

Two reasons account for those capital flows. The first (as already noted) was the general fear of continental European rulers and their investing public of having their assets confiscated during the political uncertainties and recurrent warfare on mainland Europe, particularly the period 1793-1815. As Niall Ferguson pointed out, London became the center for "managing the investment of exiled rulers."[51] The second was Britain's eventual victory over Napoleon. The political and economic stability in the country continued to attract investors to high-yielding British bonds. One can hardly argue that such capital inflows were tension-laden. They were marketplace relations forged between the British state and its transnational financial institutions—relations structured on confidence in the political system backed by effective exchange scheme.

A relatively detailed deregulation of the financial industry got underway in 1867, with some changes to the companies acts. The amendments broadened the information disclosure principle required that prospectuses contain statements of parties to every contract promoters had entered with a company.[52] Following an 1877 recommendation by the Royal Commission, the deed of settlement of the LSE was reincorporated with the LSE given institutional powers to license and regulate brokers. That amendment not only placed the LSE further away from direct government control, it reinforced its monopoly over stock market brokerage. This amendment legally empowered the LSE to self-regulate by monitoring speculative irregularities and institute reforms, when necessary. The LSE voluntarily accepted the trust reposed in it, and with time, its traders grew in

[51] Ferguson, *The House of Rothschild*, 4.

[52] Edwards, *The Evolution of Finance Capitalism*, 36. See also Hein, "The Auditor and the British Companies Act;" Poovey, "Writing about Finance in Victorian England."

number, from 1,076 in 1852 to 4,855 in 1914.[53] The LSE, as Paul Langley pointed out, was truly "the institution through which capital necessary for long-term credit creation was mobilized."[54] It was, indeed, the central edifice of the British financial order, as it was the primary means by which political and financial efficiencies were attained.

The relationship between the British state and the LSE is a clear example of pragmatic regulatory coordination. Pragmatism in this context was the monopolistic privilege the state granted the LSE.[55] A privileged monopoly can be a means to achieving effective organization of resources of both public and private interests. Monopoly allows centralization of resources, which allows concentration of power. The monopoly of the LSE depended on the will of the state. But monopolistic practice was not limited to the LSE alone; it was a general practice in the period leading to World War I and after.

VI. War and Finance in the International Marketplace Framework

The British financial order was in a relative decline from the 1890s through the coming of World War I. The immediate cause was Baring Brother's Crisis of 1890, a sovereign debt default by the government of Argentine.[56] The impact of that default on the world

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[53] Lance Davis and Larry Neal, "Micro Rules and Macro Outcomes: The Impact of Micro Structure on the Efficiency of Security Exchanges, London, New York, and Paris, 1800-1914," *The American Economic Review*, Vol. 88, No. 2 (May, 1998), 40-43. See also Edwards, *The Evolution of Finance Capitalism*, 36; Michie, "London and New York Stock Exchanges," 174.

[54] Langley, *World Financial Orders*, 56.

[55] Parker, "Regulating British Corporate Financial Reporting in the Late Nineteenth Century," 55.

[56] The Baring Brothers was an investment bank in London whose large holdings of Argentine debt could not be traded in London market by 1890. That crisis not only had tremendous impact on the British economy, it necessitated the Bank of England's rescue and cooperative assistance from the central banks of France and Russia. For details, see Kris James Mitchener and Marc D. Weidenmier, "The Baring Crisis and the Great Latin American Meltdown of the 1890s," September 2006, available from http://www.econ.berkeley.edu/~webfac/eichengreen/e211_fa06/Mitchener.pdf (accessed May 4, 2010).

financial order did not quite settle by the time the World War I storms began to gather. British bankers and financiers were not enthused with the prospects of the war; they believed it was neither in the interest of Britain nor the world. Thus, they lobbied political authorities to prevent it, and they did so to the very day hostilities flared up.[57] In fact, reports show that the Chancellor of the Exchequer, David Lloyd George, consulted with the Governor and Deputy Governor of the Bank of England and "other men of light and learning" in the City—all of whom agreed the war would "break down the whole system of credit with London as its center."[58] Of course, British financiers were not alone in their open hatred for the war. J. P. Morgan equally loathed it, as his statement in the beginning illustrates. They would have prevented it if they had the means.

Of interest to us is the consultation between financial authorities and political actors. About that kind of consultation in general, Karl Polanyi observes: "There was intimate contact between finance and diplomacy; neither would consider any long-range plan, whether peaceful or warlike, without making sure of the other's good will."[59] That is because finance is the most effective lever of power in a nation's foreign relations. It is in this sense Rudolf Hilferding observes that "political relationships" between countries "react in turn upon the economic relationships and make the country which is politically a

[57] Edwards, *The Evolution of Finance Capitalism*, 41.

[58] Edwards, *The Evolution of Finance Capitalism*, 41. As Feis rightly put it, "London became the center where the world's commerce and development was financed." For details, see Feis, *Europe the World's Banker*, 83.

[59] Karl Polanyi, *The Great Transformation: The Political and Economic Origins of Our Time* (1944), with an Introduction by R.M. Maclver (Boston: Beacon Press, 1957), 10. For a similar argument, see Peter Fearon, "Trade, Finance, and Diplomacy: The New World and the Old in the Twentieth Century," *Business History*, Vol. 32, Issue 1 (January, 1990): 100-109.

satellite into a sphere of investment reserved for the capital of its protectors."[60] That is to say, the diplomacy of a financially powerful state serves nothing less than the interests of its investment capital, which reminds us of Cordell Hull's observation that the political line-up follows the economic (or financial) line-up.

At least, two issues of marketplace relations are evident from Lloyd George's consultation. First, the consultation by itself is a marketplace phenomenon, an essential element of pragmatic regulatory coordination. Second, financial market actors detested the war because it would destroy Britain's source of strength and the financial sinews on which the empire was built. It was for this reason British financial community and state actors generally opposed to the war. On the other hand, German financiers were resolute. They deemed it necessary because it would benefit the German state and its financial industry.[61] After all, it was Germany's financial muscle that underpinned the shift of the European balance of power in its favor. We know of German financiers' war interest through a revelation one of them made about finance being his country's ultimate source of strength. He did so on the eve of Edward Grey's address to the House of Commons regarding the looming crisis. He declared:

> We do not want war, but if war there has to be we are financially in a position to carry it on without difficulty. America … also probably believes that we are not in a position to compete with England in the cost of navy building. The British Navy Minister (Winston Churchill) told a Guildhall audience so. We are not likely to alter our shipbuilding programme because of empty talk of that kind.[62]

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[60] Hilferding, *Finance Capital*, 330.

[61] See James Amemasor, "The German Power Paradox: 1890-1914: What Role Did Finance Play in Shifting European Balance of Power Towards Germany?" (Unpublished Manuscript, 2009, in author's possession).

[62] "'World Awaits Grey's Speech; His Statement Tomorrow May Profoundly Affect Anglo-German Relations," *New York Times*, November 26, 1911.

Such financial saber-rattling statement did not come from political authorities, the custodians of national power. Neither did it come from generals who are associated with hard power. It came, rather, from a war financier, "unknown" in the corridors of power.

At any rate, the statement was a clear "invitation" to war, for as A. J. P. Taylor rightly put it, "the test of a Great Power is…the test of strength for war."[63] The invitation was, indeed, made to no less a world power than Britain, and it was a strong warning that should the clouds gather into storm, the war would be fought largely in the *financial marketplace*, and that Germany was well prepared. Germany was, thus, holding its financial card very high in the "international poker game."

Indeed, the war was fought in the financial marketplace and it destroyed the gold standard regime, reignited the pre-war "financial nationalism," which was dominated by private financiers, stockbrokers, and central bankers in the City of London and on Wall Street. In a number of monetary conferences (e.g., in Brussels in 1920 and in Genoa in 1922), bankers and financiers called on governments to restore their domestic monetary systems to pre-1914 liberal order. They asked them to implement balanced budgets, cooperate with one another to resurrect the gold standard, provide regulations-free environment for central banks, and facilitate free movement of international capital.[64]

The essence of this narrative includes the relative efficiency that political actors and their credit market counterparts derived from coordinating their financial structures.

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[63] A. J. P. Taylor, *The Struggle for Mastery in Europe, 1848-1918* (Oxford: Oxford University Press, 1954/1971), xxiv.

[64] Eric Helleiner *States and the Reemergence of Global Capital*, 26-27; Eric Helleiner, "When Finance was the Servant: International Capital Movements in the Bretton Woods Order," in *Finance and World Politics*, ed. Philip G. Cerny, 21-22.

The return to the gold standard between 1919 and 1925 (a reciprocated interest of liberal political actors and their financial market counterparts) led to a recurrence of financial speculation in various capitalist economies. Lenin describes that intensive crave for financial capital as "the highest stage" in the evolution of capitalism.[65] The rigorousness of such speculative practice led to the stock market crash of 1929. It was followed by the Great Depression and World War II.

In sum, all of those international financial developments—beginning with the crisis of Baring Brother's in 1890 through World I and the Great Depression—created a "hegemonic interregnum,"[66] which enabled a consolidation of the "American system,"[67] a system whose development actually dates back to the 1790s. Although the roots of the American financial order started that early, it was not until late 1900s that it gathered enough political nutrients.

4. FINANCIAL GOVERNANCE IN THE U.S.

The political vision of making the U.S. the dominant financial center of the world was clearly articulated by Senator Aldrich in 1910, when he noted:

I have a *plan* … or I should more properly say a firm purpose to find a *plan*, to

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[65] According to Lenin, the billions of profit returns on export capital were the result of a cyclical convergence of capitalists yearning for "concentration of production," investment monopolies, and an ever-increasing search for "new capital for the new enterprises." For details about the role of pre-1914 private bankers in the world of finance, see Lenin, *Imperialism, the Highest Stage of Capitalism*, 9- 17.

[66] See Ruggie, "International Regimes, Transactions, and Change," 391; Niall Ferguson, "Hegemony or Empire," *Foreign Affairs* (September/October, 2003).

[67] Ikenberry, "A World Economy Restored: Expert Consensus and the Anglo-American Postwar Settlement." See Chales Kindleberger's definition of hegemonic leadership theory in Odell, *U.S. International Monetary Policy*, 35. He defines leadership in the context of hegemony "as setting standards of conduct, seeking to get other states to observe them, and, especially, assuming a disproportionate share of the burden of defending the system itself in a crisis." See also Peter Burnham, *The Political Economy of Postwar Reconstruction* (New York: St. Martin's Press, 1990) for an explanation on hegemonic theory.

> make the United States the financial center of the world, a position she is entitled to by virtue of her resources, her vast accumulations of wealth, and her surplus capital. [68]

That commitment to build an incontrovertible center of world finance would benefit the financial community, but it would first be deeply rooted in the political structure itself. Aldrich's vision became a complete global reality by the time World War II ended. We will examine that reality by gleaning over its historical development and growth. In doing so, we will place emphasis on the relative benefits that political authorities and financial market institutions derived from the country's status as a world financial center.

I. The Birth of a Nation: National Debt and the Marketplace Framework

It would be a fair assessment to say that if Thomas Jefferson's independence declaration was the majestic superstructure of the political union, Alexander Hamilton's ingenious financial vision was the infrastructure of that constitutional compact. That is to say the effective beginning of financial market operations in the U.S. is credited in large part to the visionary policies of Hamilton, the first Secretary of the Treasury. With his vision, determination, influence, and persuasion, the U.S. government assumed the nation's revolutionary war debts, including federal, state, and foreign obligations. The political, social, and economic benefits of the national debt cannot be underestimated. Primarily, it "cemented" the union of the thirteen original colonies and ensured "continuance and maintenance of a strong central government," which was essential for territorial security, national economic growth, development of financial capitalism, and projection of national power on the international stage. All of these are essential elements of the

[68] *An Address by Senator Nelson W. Aldrich*, 29.

marketplace framework. A creative thinker as he was, Hamilton strongly believed the national debt would be a blessing, and he was right, without the slightest doubt.[69]

At the heart of Hamilton's policy was government's refund of the war debts by way of selling federal bonds. Contrary to common belief, Hamilton was not a fan of big spending government; he and Jefferson were equally concerned about the national debt and its political implications. But Hamilton was a pragmatic, farsighted aristocrat with a unambiguous sense of the political derivativeness of finance. To that end, he was reported to have stated that:

> as the vicissitudes of nations beget a perpetual tendency to the accumulation of debt, there ought to be, in every government, a perpetual, anxious, and unceasing effort to reduce that which at any time exists, as fast as shall be practicable, consciously with integrity and good faith.[70]

The government bonds were, indeed, organized and were coordinated by the First Bank of the United States, a chartered central bank modeled on the Bank of England. Trading in those bonds marked the beginning of American financial capitalism. In fact, the bonds were the only form of security investment in the new nation. As Robert Wright noted, organization of a secondary market for those bonds "opened the door to a wide variety of other capital market instruments, including corporate equities (stocks) and bonds."[71] The existence of the federal government bonds is a true reflection of marketplace relations. Two reasons explain this. From financial perspectives, U.S. credit markets would not

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[69] For a detailed analysis of the importance of government debt in the context of the U.S., see Wright, *One Nation Under Debt: Hamilton, Jefferson, and the History of What We Owe*, 13; Edwards, *The Evolution of Finance Capitalism*, 140. Gordon, *Hamilton's Blessing*; Bruce Miroff, "Alexander Hamilton: The Aristocrat as Visionary," *International Political Science Review*, Vol. 9, No. 1 (January 1988): 43-54.

[70] Edwards, *The Evolution of Finance Capitalism*, 140-141.

[71] Wright, *One Nation Under Debt*, 14. See also Wood, “Inventing American Capitalism.”

have emerged at the time it did without the federal debt. From political standpoint, the thirteen original colonies could not have consolidated without the existence of the debt market. We can see from this the cognate origin/burden of politics and finance.

Effective patronage of the government bonds marked the beginning of the great game of speculation in securities, one of the first pulsating political issues the emerging nation had to deal with. As John Steele Gordon put it, the "federal and state bonds were the meat and potatoes of the new securities brokerage, the 'hottest' security was the stock in the Bank of the United States, which was capitalized with $10 million, a vast sum for that time and place."[72] In other words, the national debt via securities brokerage was the uniting political principle. Through small shares, the bonds offered the public a financial stake in the democratic affairs of the young nation. This sense of "ownership" bolstered political stability and jump-started rapid economic growth. Wright notes in this regard:

> Throughout the land, [the people] bought the new government's IOU at high prices and sold them at will, sometimes to people in distant lands eager for good investments. Through such trading, the interests of the governed and the government became one. The debt blessed the nation as bankruptcy turned to honor and despair to hope. The fruits of their labors now secure, the people worked hard and smart.[73]

One does not have to hesitate in asserting that, therefore, that Hamilton's policy of reducing the national debt through the buying and selling of federal and state bonds laid

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[72] Gordon, *The Great Game: The Emergence of Wall Street,* 31, 37.

[73] Wright, *One Nation under Debt*, 1. A similar view is argued by T. H. Breen, when he noted, "[The American] colonists' shared experience as consumers provided them with the cultural resources needed to develop new form of political protest. In this unprecedented context, private decisions were as political acts; consumer choices communicated personal loyalties. Goods became the foundation of trust, for one's willingness to sacrifice the pleasures of the market provided remarkably visible and effective test of allegiance." See T. H. Breen, *The Marketplace of Revolution: How Consumer Politics Shaped American Independence* (New York: Oxford University Press, 2004), xv-xvi.

the actual foundation of U.S. financial capitalism. There are at least two reasons why the policy shows a marketplace relation, both in domestic and the international dimensions.

First, the capital size and monopoly position of the central bank as the federal government's monetary institution provided confidence, authority, trust, and certainty, which are fundamental for the functioning of the marketplace framework (see Chapter 3). Second, apart from the federal government's obligation to purchase 20 percent shares of the bonds, the remaining 80 percent was floated in European and other stock markets, including Bermuda, Amsterdam, Bordeaux, and Bristol in England. Those who bought them came from at least 87 different places with diverse professional backgrounds.[74] Trading of the bonds on foreign stock exchanges was an excellent source of credibility for the U.S. government and the country as a whole. It generated confidence and trust in public and private financial institutions in Europe and elsewhere, and attracted financial institutions, businesses, and capital markets to interact in Hamilton's visionary, newly developing market located on Wall Street.[75]

As Wright argues and rightly so, the history of the U.S. national debt shows that "foreign ownership of government bonds can be a very good thing."[76] That is to say trans-Atlantic confidence and trust in financial products and instruments on Wall Street constituted the international dimension of U.S. marketplace framework. Such provided a solid foundation for Wall Street as the hub of American capitalism. More importantly, it created vibrant marketplace relations between what Alexander Hamilton called "honest

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[74] They include bricklayers and housepainters. See Wright, *One Nation under Debt*, 248.

[75] Gordon, *The Great Game: The Emergence of Wall Street*, 37.

[76] Wright, *One Nation under Debt*, 15.

men and knaves, between respectable stockholders and dealers in the funds and mere unprincipled gamblers,"[77] and between private and public financial realms, involving transnational market participants. This kind of relationship reminds us of J. P. Morgan's statement at the beginning of the chapter about his role in building confidence and trust between the U.S. and the capital markets of Europe for the flow of credit for America's public and private needs. Specifically, the marketplace relation in this context is transnational in nature, for it reflects diverse financial systems exposing their respective political economy to external realms while internalizing the horizontal sphere into their particular domestic/internal realms. But unlike the British financial system, which is organized in a unitary political system, U.S. financial markets (organized in a peculiarly fragmented political system) faced great challenges in their early period. The complexity of the federated system, particularly the constitutional tension between the powers of the federal government and the rights of the constituent states (interspersed with what Cerny calls "populist suspicion of centralized power"[78]) did not help the smooth development of the country's financial system. The struggle was clear in the failure to renew the charters of the First and the Second National Banks. In effect, evolution of U.S. financial markets was hampered by the rise of Jacksonian-Democrats and the partisan politics of the time.

II. Organizing Credit Without a Central Bank: The Marketplace in Domestic and International Contexts

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[77] Ron Chernow, *Alexander Hamilton* (New York: Penguin Books, 2004), 383; Gordon, *The Great Game: The Emergence of Wall Street*, 35-51.

[78] Cerny, "Money and Power: The American Financial System from Free Banking to Global Competition," 176.

In the absence of a central bank, overlapping private and state banking institutions dominated the nation's financial landscape. But they were not able to effectively coordinate the system, which made financial capital largely immobile. Immobile capital is, in effect, dead capital. Immobile capital does to an economy what blood clot does to the human body: organs are starved, they lack energy and are, therefore, inactive. Capital immobility distorted the nation's economic growth and development throughout the nineteenth century. The shift in the nation's industrial activities from the eastern portion to the western section, a few decades before and after the Civil War, led to a rise in demand for mobile external investment capital to build the country's communications infrastructure and integrate the economy. Inter-state railroads, turnpikes, and canals were financed through the issuance of corporate bonds, most of which were sold on exchanges in Europe.[79] In essence, the restoration of capital movement in the post-bellum period helped financial capitalists to gain national prominence. Such would not have been possible without the international dimension of the marketplace relation: the coordination of national financial systems within the framework of international political relations.

Although long-term financing of industrial enterprises in the western part of the country came from east coast surplus saving units, the bulk of those funds originally came from abroad, particularly, England through banker capitalists such as J. P. Morgan, Andrew Carnegie, and John D. Rockefeller—America's financial intermediaries of the

[79] This period witnesses the growth of interstate corporations in the U.S., a major source of national economic integration. See Lance E. Davis, "Capital Immobilities and Finance Capitalism: A Study of Economic Evolution in the United States 1820-1920," *Explorations in Entrepreneurial History,* Series 2: 1:1 (Fall 1963), 88-100; Edwards, *The Evolution of Finance Capitalism*, 141; Huntington, "Transnational Organizations," 340-341.

time. Morgan was the most successful intermediary. His reputation in global finance was based on his personal foreign connections. For instance, when Congress delayed military appropriation bill for western army payrolls in 1877, Morgan offered to provide funds at one percent discount rate, when the best local option available was at twenty-five percent interest rate (Davis, 95). When all is said that can be said about Morgan, he was a financial genius because of the trust he commanded among his fellow capitalists and the confidence he injected into the veins of statesmen and politicians.

Morgan was highly regarded not only because of his brilliance in the marketplace relations, but as Carlos Ramirez noted, the monitoring services he provided his client corporations assuaged market imperfections, curtailed "principal-agent problems," reduced asymmetric information between managers and investors, which partially solved their internal financing problems.[80] Those relations, particularly, between himself and state authorities were not tension-laden; they reflect marketplace framework—relations for the greater good of finance, politics, and society across transnational space.

The development of intra-American state corporations, Huntington argues, was the actual source of integration of the U.S. as "a national community" in that it helped lessened the "struggle over the Constitution and much of the political controversy of the first part of the nineteenth century."[81] Financial institutions and agents played crucial roles in the integration process. They did not only organize shares and bonds of the

[80] Carlos D. Ramirez, "Did J. P. Morgan's Men Add Liquidity? Corporate Investment, Cash Flow, and Financial Structure at the Turn of the Twentieth Century," *The Journal of Finance*, Vol. 50, Issue 2 (June 1995): 661-678.

[81] Huntington, "Transnational Organizations," 340-341. See also Richard Sylla, "Federal Policy, Banking Market Structure, and Capital Mobilization in the United States, 1863-1913," *The Journal of Economic History*, Vol. 29, No. 4 (December 1969), 686.

corporations, they were the conveyor belts linking surplus savings units with deficit spending units across local and international political space. In essence, they were the sinews of the economy and the source of the instruments of commerce. By helping integrate the economy, corporations and financial institutions helped themselves by increasing their domestic and international market shares. As a result of the integrated national economy, the federal government was increased its tax base. The marketplace relation is that credit markets made the country a cohesive national, political community.

In a paradoxical manner, it was the demands of pre-bellum political organizations and interest groups opposed to operations of financial institutions that helped to lay a firm foundation for U.S. credit markets. For instance, it was the Free Banking Act of 1838, passed by the state of New York, that inadvertently underpinned the strength and distinctiveness of U.S. financial system. The "bond-secured currency" clause of that act required bankers who wanted to issue bank bills to deposit "an equal amount of bonds with the state comptroller."[82] Basically, the law was designed to break up monopolistic practices in the banking industry and thereby increase competition and efficiency. By 1860, eighteen of the federated states adopted it. But instead of its intended effect, the law contributed to pervasive deterioration in the quality of banking. The deterioration shifted public confidence and trust into securities investment and actually laid grounds for the National Banking Act of 1863, whose immediate purpose (following suspension of species payment) was to provide sound, easily convertible currency for large scale

[82] Edwards, *The Evolution of Finance Capitalism*, 142. Gerald P. Dwyer Jr., "Wildcat Banking, Banking Panics, and Free Banking in the United States," *Economic Review*, Vol. 81, No. 3-6 (December 1996), 4.

governmental transactions. The major government business in question was the urgent need to suppress the Southern rebellion.[83]

III. Marketplace Framework via the National Banking Act of 1863

The National Banking Act of 1863 (proposed by Secretary of the Treasury, Salmon P. Chase) repealed the Sub-Treasury Act of 1846 and ended the issuance of paper currency by state and local banks. It introduced a sounder national "medium of exchange and credit," thereby, enabling the federal government to sell its bonds in the broader open market. In short, the 1863 Bank Act provided the legal basis for the national system of banking, a single most important development that enabled the federal government to effectively suppress the War for Southern Independence. As Robert J. Walker notes, the Sub-Treasury Act of 1846 (which he introduced as the 18th Secretary of the Treasury) "divorced" banks from the federal government, enlarged circulation of gold and silver specie, and restrained excessive issue of bank notes.[84] In effect, the National Banking Act reversed those conditions and "reunited" banking with the federal government.

The impact of the Sub-Treasury Act vis-à-vis the marketplace relations was best expressed by Congressman E. G. Spalding of New York. To him, "The Independent Treasury law [i.e., the Sub-Treasury Act] *unnecessarily isolated* the Government from all

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[83] John Wilson Million, "The Debate on the National Bank Act of 1863," *The Journal of Political Economy*, Vol. 2, No. 2 (March 1892), 251; E. G. Spaulding, "Specie Payments: Why the Banks Suspended in 1861—Effect of the Sub-Treasury Law—Letter from E. G. Spaulding," *New York Times*, April 27, 1870.

[84] See reference in Million, "The Debate on the National Bank Act of 1863," 252. See also William G. Dewald, "The National Monetary Commission: A Look," *Journal of Money, Credit, and Banking*, Vol. 4, No. 4 (November, 1972), 935-936.

the capitalists and the accumulated capital of the country" (emphasis added).[85] Spalding's statement is a very important expression of the fundamentals of the marketplace framework, for two related reasons.

The first has to do with the issue of *isolation*. That is, governments of advanced liberal capitalist states do not *unreasonably separate* themselves from the capitalists and their concentrated capital. This is true, particularly when one reflects on Huntington's "power paradox" (see chapter 2) in the sense that the notion of "isolation" creates an "IvI gap"—the gap between political thought and political institutions. In our context, the gap is between the liberal state and its financial authorities. The existence of such a gap makes the power of advanced liberal capitalist states effective. In fact, Huntington's "IvI gap" theory truly accentuates Grey's account of British policy regarding financial market institutions. In both states, "isolation" of capitalists and their accrued capital from their governments implies tensile relations. However, as Spalding rightly pointed out, that is not the case. In theory, the concept of *isolation* may signify tensile, dogmatic relations. But in practice, it is the fundamental principle of pragmatic regulatory coordination.

The second reason is the role of the legal system in *designating* the relationship between advanced liberal state and its financial capital base. Fundamentally, it is the *law* that "defines" the relationship between the government and all other institutions—private and public—at any given time. The law "divorces" financial market institutions from the

[85] See Miller, *Great Debates in American History*, 218. See also "Our National Finances: Remarks of Hon. E. G. Spalding in the House of Representatives," *New York Times*, February 22, 1863. The Sub-Treasury Act of 1846 charged regional banks to issue, receive, transfer, circulate, disburse, sell, discount bills and promissory notes, and keep public money on behalf of the US federal government. See *The New York Times* report of May 30, 1868, on U.S. Supreme Court interpretation of the Sub-Treasury Act of 1846 with reference to the 1863 National Bank Act under the title, "Law Reports; Custody of the Public Moneys under the Sub-Treasury Act of 1846—Embezzlement under that Act—Dissenting View as to 'Officers' Indictable."

liberal state when the need arises. It is also "reunites" them when such is deemed critical. The supreme institution that makes the laws of the state is the government. Therefore, the kind of relationship that exists between the liberal state and its financial base at any given time is what state authorities *designate* such to be. Liberal capitalist states legally "divorced" private influence from public authority in ways that appear tensile. The best way to conceptualize this relationship is via the marketplace framework, which is the coordinated system that neither isolates nor unites the state with its financial base.

Robert Walker provided the most authoritative merit for the banking reunion act, which as he argued, was necessary to address the crucial political demands of the Civil War. As he pointed out then, the government could only win the war by implementing a vigorous "financial policy" based on a uniform national currency backed by the federal government security. National currencies in that sense mean a stable, easily convertible, and harmonized medium of credit and payment. A national currency was absolutely necessary in view of the fact that the paper currencies issued by local and state banks lacked uniformity, stability, and national security. They did not equally appeal to security holders because their circulation, value, and acceptance depended on the laws of thirty-four states and the preferences of about 1,600 private corporations.[86] The idea of a uniform currency as the foundation for political strength was aptly articulated by Senator John Sherman who was reported to have said on the Senate floor: "we cannot maintain our nationality unless we establish a sound and stable financial system; and as the basis

[86] Million, "The Debate on the National Bank Act of 1863," 252-253. See also Dwyer Jr., "Wildcat Banking, Banking Panics, and Free Banking in the United States."

of it we must have a uniform national currency."[87] As I pointed out in earlier chapters, a stable, uniform national currency is the superglue of the marketplace framework. It is the means by which the state concentrates and centralizes its power and authority. The logic of a coordinated relation between the state (being the source of "coercion") and finance (being the "bellows" fanning economic growth and development of states) fits the context of Spalding and Sherman's arguments as elaborated above.

In fact, we can see from the foregoing that the National Bank Act of 1863 was not a source of tension between the U.S. government and its financial structures. It rather promoted (explicitly and implicitly) public authority and market authority, concurrently. In the words of Secretary Chase, the Act was meant to establish a "sound, uniform circulation of equal value throughout the country upon the foundation of national credit combined with private capital."[88] Its immediate purpose, as I noted earlier, was to facilitate the sale of federal government bonds for the suppression of the Confederate rebellion. The long-term goal was the need for a uniform, stable national currency—the United States Legal Tender Notes or the "greenbacks." The lack of a national currency did not help in suppressing the rebellion. It also did it facilitate integration of the national economy as a cohesive unit. The absence of such currency was the federal government's abdication of its "essential national authority" to the 34 states then constituting the Union.

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[87] John Sherman, *Selected Speeches and Reports on Finance and Taxation, from 1859-1878* (New York: Appleton and Company, 1879), 78. See a version of this quote in Million, "The Debate on the National Bank Act of 1863," 258.

[88] Quoted in Million, "The Debate on the National Bank Act of 1863," 264.

In effect, the abdication was, a *sine qua non*—the rebellion would not have happened in the first place had the federal government not abdicated its authority.[89]

Following this view, the national banking law was an integral part of the political system; it was an acknowledgment that the liberal state has responsibilities it should not neglect. The power to create and regulate the value of national currency is implicit in the constitutional character of the state itself, a basic element of its sovereignty. And it did exercise that sovereign and reinforced the sense of nationality. As noted in the previous chapters, security and stability are critical components of the marketplace framework. Insecurity is the first sign of an unhealthy political system. In that sense, the National Bank Act truly harmonized public/private interests, an affirmation that public good and self-interest are one and the same. The marketplace relation is about harmonizing the seemingly different public/private realms for relative efficiency of politics and finance.

When the constitutionality of said law was brought before the U.S. Supreme Court (two years before Congress passed it), the Court ruled in favor of the federated states. However, within the spirit of the Constitution, Congress disregarded the Court's decision and passed the bill on grounds that public welfare required suppression of state banks,[90] which is a further confirmation that protection of public interests is inherently a protection of private interests. The marketplace relation or significance of that law is as relevant today as it was 148 years ago. As Mark Furletti put it, that statute is "one of the most influential forces in the formation and development of the U.S. credit card industry" because it has given "nationally chartered banks a wide range of powers and protections,"

[89] Million, "The Debate on the National Bank Act of 1863," 269.

[90] Million, "The Debate on the National Bank Act of 1863," 266.

one of which is the ability to "preempt a variety of state and municipal regulations involving credit card interest rates, fees, and disclosures."[91] In other words, the law made it possible for credit institutions to flourish across the country, a development that in its essence is a marketplace phenomenon rather than a tension relation.

IV. Marketplace Framework in Domestic and International Contexts: 1890s-1945

Between 1836 when the Second National Bank charter expired and 1913 when the Federal Reserve Bank was established, the U.S lacked a bank of last resort. The absence of such an institution meant a lack of centralized, coordinated credit organization. In that scheme of things, state-chartered banks dominated the country's financial landscape. The nation experienced not only the most inept system of payment, but the most intermittent financial panics in the world. This accounts for the nation's dependence on financial capital from European (mainly British) investment banks, many of which had branch offices in U.S cities on Atlantic seaboard.[92]

The marketplace relationship between U.S. government and U.S. investment banks (in internal and foreign realms) becomes clearer when one examines the famous "gold loan of 1895." This loan was floated as a result of the financial panic of 1893, which caused economic depression in the country. With high unemployment rate amid gridlock Congressional "currency legislation," the U.S. found it difficult to maintain the gold payment system—difficult because the U.S. dollar was not an international currency then. Faced with balance of payment problems, the government's gold reserves depleted

[91] Mark Furletti, 'The Debate Over the National Bank Act and the Preemption of State Efforts to Regulate Credit Cards," *Temple Law Review*, Vol. 77 (2004), 425.

[92] They included the Rothschild and Baring Brothers, U.S. government's London agent.

to $42,000,000 by February 1895. Unstable international financial conditions in Europe, which culminated in a suspension of Baring Brothers, worsened the U.S. situation. It was complicated by the government's unsuccessful effort to sell bonds to the investing public to replenish its gold funds. Upon a request from President Cleveland and his Secretary of the Treasury, John H. Carlisle, J. P. Morgan & Co. secured a loan of $50,000,000, mostly from European private financial institutions for the government.[93] Populist rabble-rousers criticized the deal and labeled the administration as a tool in private financiers' pockets.

In any case, the deal was evidence of the marketplace relation, for it allowed the U.S. not to default. The country would have abandoned the gold standard without it. And that would have had major impact on the international political economy.

The marketplace relation in its international dimension could be understood at another level. American reliance on British credit markets made a member of Congress to say: "the barometer of the American money market hangs up at the stock exchange in London."[94] He was not alone; a Boston stock broker uttered a similar thought in 1834:

> This immense engine of finance is now so intimately connected with monetary matters in our own country that the slightest throb of its quickening pulse has a controlling influence on movements in State or Wall Street.[95]

These statements are not far from the truth when they are understood from the context of the marketplace framework. In fact relations (in domestic as well as in international

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[93] Chernow, *The House of Morgan*, 74-77. See also Edwards, *The Evolution of Finance Capitalism*, 172.

[94] Edwards, *The Evolution of Finance Capitalism*, 144; Chernow, *The House of Morgan*, 4-5. See also Robert Sobel, *Panic on Wall Street: A History of America's Financial Disasters*, reprinted (Washington, D.C.: Beards Books, 1999), 42,

[95] Joseph G. Martins, *Twenty-One Years in Boston Stock Market* (Boston: bedding and Company, 1856), 70. See also Sobel, *Panic on Wall Street*, 44.

perspectives) between politics and finance are cognate in origin, process and function, although they may seem to have independent existence in ordinary practice. Edwards notes of such relationships in the period leading to World War I as follows:

> Corporations and even governments in most cases developed a closed or continuous relationship with one investment house which came to know intimately the financial position of the particular corporation or the government, and was able to offer constructive advice on the latter's general financial policy.[96]

Although such relations existed, the nonexistence of U.S. central bank meant a lack of effective regulatory coordination of the engine of industrial organization.

The lack of coordination led to over competition, pervasive speculations, overcapitalization of corporate assets, security price depreciations, deterioration in the quality of investments, unreliable financial statements, and widespread losses by stock holders. These unsound market practices led to loss of trust and confidence and gave rise to what Morgan described as "undigested securities" or "ingestible securities" (James J. Hill).[97] They were so described because of lack of investment capital to absorb them.

The overall impact of the lack of trust, confidence, and capital was frequent and precipitated financial panics. The 1907 panic was a nation-awakening one. Its disastrous and destructive influence reverberated around the world. The immediate cause was "a simultaneous rush to sell securities by holders who perceived that there was trouble in the

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[96] Edwards, *The Evolution of Finance Capitalism*, 230.

[97] "J. P. Morgan is Bullish: Financier Believes Prosperity Will Last Long," *New York Times*, March 31, 1903. For an analysis of market implications of Morgan's terminology, see Milton J. Plant, "Undigested Securities: Reassuring Considerations Affecting their Volume, their Value, and their Future," *New York Times*, April 26, 1903. See also Edwards, *The Evolution of Finance Capitalism*, 187-189.

money-market and who wanted cash to meet maturing obligations."[98] As Edwards noted, "the panic of 1907 further demonstrated the inability of even highly organized finance to control the conditions which lead to boom and subsequent collapse." Indeed, the failure of organized finance to bring the economy to an upturn lasted until 1915 before World War I provided the country with an "artificial prosperity."[99]

The systemic impact of those frequent, destructive panics/shocks, including the loss of investor confidence and depositors' trust in financial products and instruments, compelled the federal government to find ways to relieve the congestion and danger as well as to find lasting solution. That need for an enduring solution made Congress to establish the National Monetary Commission (NMC). The NMC was asked to study and recommend the best banking options available. Its recommendations, reinforced by the Pujo Committee's Money Trust Investigation,[100] laid the conceptual foundation for the Federal Reserve Act of 1913—the law that established the Federal Reserve System (or Fed), the "first among equals" in the entire federal bureaucracy.

5. THE FEDERAL RESERVE SYSTEM AND THE MARKETPLACE FRAMEWORK

According to Michael Munger and Brian Roberts, "the Federal Reserve System is perhaps the most controversial non-elected element of the government of the United

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[98] Horace White, "The Hughes Investigation," *The Journal of Political Economy*, Vol. 17, No. 8 (October 1909), 528.

[99] See Edwards, *The Evolution of Finance Capitalism*, 189-190.

[100] *Money Trust Investigation: Investigation of Financial and Monetary Conditions in the United States under House Resolutions Nos. 429 and 504 before Subcommittee of the Committee on Banking and Currency* (Washington: Government Printing Office, 1913); Vincent P. Carosso, "The Wall Street Money Trust from Pujo through Medina," *Business History Review*, Vol. 47, No. 4 (Winter, 1973): 421-437.

States. Journalists and voters vilify it, Congress and the President seek to dominate it, and scholars argue about it."[101] This observation is right on the mark, as commentaries on the ongoing financial crisis reveal.[102] Whether the Fed is a political institution or just an economic institution remains is an issue scholars continue to debate. My goal is to elaborate on the Fed's functions as far as the marketplace framework is concerned.

We can understand the kind of institution the Fed is by reflecting on the events, circumstances, and the processes that guided its establishment. Those circumstances (as explained above) were political in nature and international in context. They constitute a definitive realization that finance is politics and politics is finance.[103] Establishing the Fed was motivated by both financial market participants (particularly New York banking community) and political authorities who wanted to internationalize the U.S. dollar as a mechanism to reduce recurring financial problems in the country.[104] Another motivation was the vision to make New York compete with London as a world financial center. As stated earlier, Aldrich laid the vision for the Fed clear when he noted that he had a "firm purpose" to find a plan that would make the U.S. the center of world finance. This was exactly the context in which the Fed was established. It was set up to perform salient,

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[101] Michael C. Munger and Brian E. Roberts, "The Federal Reserve and Its Institutional Environment: A Review," in *The Political Economy of American Monetary Policy*, ed. Thomas D. Willet (Cambridge: Cambridge University Press, 1990), 83.

[102] See Paul Krugman, "Feckless Fed," *New York Times*, July 11, 2010; Sewell Chan and David M. Herszenhorn, "Consensus for Limits to Secrecy at the Fed," *New York Times*, May 10, 2010; Tom Braithwaite, "FDIC Blames Federal Reserve for Severity of Financial Crisis," *Financial Times*, January 15, 2010; Michael J. Burry, "I Saw the Crisis Coming. Why Didn't the Fed?" *New York Times*, April 3, 2010; Sewell Chan, "Greenspan Concedes that the Fed Failed to Gauge the Bubble," *New York Times*, March 18, 2010.

[103] Richard H. Timberlake, "Institutional Evolution of Federal Reserve Hegemony," *Cato Journal*, Vol. 5, No. 3 (Winter 1986), 743; Morris, *Congress, the President, and the Federal Reserve*, 4, 6.

[104] For a detailed account on the international origin of the Fed, see Broz, *The International Origins of the Federal Reserve System.*

systemic functions that are monetary on the surface but political in nature. The Fed does a lot in that regard (see chapter 4).

The Fed's most important function, the postulating and unifying function, is the conduct of monetary policy—indirect control of the quantity of money in circulation. It does so, as Greenspan declares, by "controlling the monetary base, mainly currency and bank reserves."[105] Controlling circulation of money and finance constitutes the core of the political economy. As already noted (in Introduction and Chapter 3), the price system upon which the market economy is based depends on the management of the country's monetary foundation. Thus, more than any other bureaucratic agency, the Fed is the only institution whose policies affect the economy directly or indirectly. Its management of the quantity of money in circulation affects the value of money, and thus the price of credit. Recognizing such immense power, Steven Becker accurately observes: "No one can afford to ignore the Fed."[106] In effect, the Fed's institutional power to manipulate currency movement and thus affect the price of credit, explains the institution's relevance to the marketplace framework.

Apart from this conventional function, one also needs to examine the Fed's institutional structure, political relationships, the kind of information available to it, how it utilizes that information (and for what purposes) in order to understand the type of institution it is. The structure of the Fed is pyramid-like, with a private base, a mixed middle level of 12 regional banks (or branches spread out in the country), and a public

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[105] Greenspan, *The Age of Turbulence:* 85, 92. See also Morris, *Congress, the President, and the Federal Reserve*, 1; Greider, *Secrets of the Temple*.

[106] Quoted in Morris, *Congress, the President, and the Federal Reserve*, 1.

tip.[107] The apex is composed of the Federal Open Market Committee (FOMC)—made up of a public/private base—and seven-member Board of Governors (BOG) appointed by the President and confirmed by the Senate for 14-year terms.[108] The FOMC and the BOG meet to set monetary policies. The 12-member FOMC—consisting of the seven BOG members and five regional reserve bank presidents—are chosen by shareholders of the twelve regional banks. The BOG is the public counterbalance of the FOMC. Through voting, the FOMC decides the terms for the open market operations (or the trading of government securities). It also determines the target price for the federal funds rate (the basic rate at which commercial banks lend to other commercial banks). In other words, the Federal Reserve funds rate (FRFR) is the indicator of the price (or cost) of overnight borrowing between commercial banks. It is used to assess the general performance of the economy and determine the appropriate policy response at any given time.

By conventional understanding, the Fed is usually considered a politically neutral institution because of its structure, control, and ownership. Apart from that, its budgetary requests do not come from the central government. In fact, the Fed does not have any budgetary problem at all. It rather gives billions of dollars to the government through the Treasury Department. The Fed, in other words, is self-funding. It generates revenue from receipts on interest payments on open market operations. As a quasi-private and quasi-public 'self-regulating' institution, the Fed's decisions cannot be ratified by the

[107] Michael D. Reagan, "The Political Structure of the Federal Reserve System," *The American Political Science Review*, Vol. 55, No. 1 (March 1961): 64-76.

[108] Morris, *Congress, the President, and the Federal Reserve*, 2.

executive or legislative branches of government. The President, however, can remove its board members for any just cause.[109] But the removal power has never been exercised ever since the institution was created. From central bank independence perspective, the Fed is legally insulated from political influence. From principal-agent perspective, the President has constitutional power to exert influence over the institution through agenda setting and legislative veto-like decisions.[110] Thus, it is not easy to classify the Fed simply as an economic or political institution.

Thus, thinking about the structure and functions of the Federal Reserve reminds us of Huntington's theory of the power paradox and the necessity of covering up power. It is imperative to cover up power because the consciousness of power induces distrust, antagonism and resentment.[111] Thus, within the context and import of Huntington's power paradox, one can argue that the Fed is *insulated* from open political processes in order to be effective. Its obligations are political, but concealed as "independent" monetary policies. Ultimately, the role of the Fed is critical to understanding the marketplace framework. Its policies must be viewed through the lenses of politics. When all is said that can be said about the institution, its establishment brought a great measure

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[109] Morris, *Congress, the President, and the Federal Reserve,* 3; G. L., Bach, "The Machinery and Politics of Monetary Policy-Making," *The Journal of Finance*, Vol. 8, No. 2 (May 1953), 170.

[110] Morris, *Congress, the President, and the Federal Reserve,* 8; Schneider and Ingram, *Policy Design for Democracy*; Thomas Havrilesky, "Monetary Policy Signaling from the Administration to the Federal Reserve," *Journal of Money, Credit, and Banking*, Vol. 22, No. 1 (February 1990), 84. See also Regan, "The Political Structure of the Federal Reserve System," 64

[111] The fact that the Fed has been constructed as "apolitical" institution and treated as a public-interest economic agency helps understand why political scientists paid "little attention" to its politics and policy-making before the 1960s and early 1970s. Such a perspective made intellectual and public concern for the politics of financial and monetary policy dormant. But the development of public-choice theory—whose basic "assumption is that political actors are personal utility maximizers"—provided the impetus for a reconsideration of the public-interest view. In that sense, Morris argues that Fed policymakers are, by definition, "political actors." For details see Morris, *Congress, the President, and the Federal Reserve,* 5. On Huntington, see *American Politics,* 75-76.

of stability to U.S. financial system until post-World War I era of high finance, marked by financial and monetary nationalism ultimately culminating in the stock market crash of 1929. The crash was followed by the collapse of the gold standard payment and the Great Depression. The relationship of politics and finance in the New Deal programs offers valuable windows of evidence about the marketplace framework.

6. THE NEW DEAL, INTERNATIONAL FINANCIAL CRISIS AND THE KEYNESIAN WELFARE STATE

Coming into office on the turbulent of the waves of the 1930s, President Franklin Delano Roosevelt (FDR) and his appointees understood clearly the underlying causes of the Great Depression—financial nationalism—and, in fact, dealt with its roots through a set of economic and social policies. The New Deal was a series of policies and programs for restoring American progress. FDR set the tone of those policies in his first inaugural address and subsequent remarks.[112] The address focused primarily on calming public fears and restoring public trust, confidence and certainty in the market economy, a tone which by its very nature, was a marketplace phenomenon. The driving philosophy was social in disposition and content, for the administration 'subordinated' private interests to

[112] FDR's inaugural speech emphasized that the American progress would be impeded if any large body of its citizenry should fall behind. See "Text of the Inaugural Address; President for Vigorous Action," *New York Times*, March 5, 1933; Franklin Delano Roosevelt, "Fireside Chat 1: On Banking Crisis," March 12, 1933, available from http://millercenter.org/scripps/archive/speeches/detail/3298 (accessed March 31, 2010). Economic historians are divided on the social and economic impact of the New Deal. Some argue that the New Deal fell short of solving the social problems of the Great Depression because it "failed to make businesses more responsible" and, instead, strengthened their "political power." For details, see Barton J. Bernstein, "FDR: Savior of Capitalism," in *Major Problems in American History, Volume II: Since 1885: Documents and Essays History*, ed. Elizabeth Cobbs Hoffman and Jon Gjerde, 237.

the collective good. The administration understood that the nation could only recover from the Depression when a large body of the citizens was put to work.[113]

At the heart of those programs was the Keynesianism of government intervention in the monetary and financial sectors of the economy. The New Deal planners believed that financial plutocracy is fundamentally incompatible with liberal democracy; hence, the need for pragmatic regulatory coordination of politics and finance for the greater good of the country. Such a practical consequence of finance required dislodging stockbrokers, private financiers and bankers as the levers of politics from the temple of finance.[114] As Henry Morgenthau Jr., Secretary of the Treasury put it, the New Deal programs could only succeed when the world's financial centers were moved from the City of London and Wall Street to U.S. Treasury. Consequently the U.S. government got involved directly in financial and monetary management, instead of leaving such primarily to private bankers, financiers, and speculators. The government appointed a new class of professional economists, industrialists, and labor leaders to the Treasury who, indeed, shaped relationship of politics and finance in a true marketplace fashion.

The New Deal policies culminated in the Securities Act of 1933, which like the British Companies Act of 1844, requires "full and fair disclosure of the nature of security

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[113] See "Text of the Inaugural Address;" See also David M. Kennedy, "FDR: Advocate for the American People," in *Major Problems in American History, Volume II: Since 1885: Documents and Essays*, ed. Elizabeth Cobbs Hoffman and Jon Gjerde (Boston and New York: Houghton Mifflin Company, 1998), 229.

[114] See "Text of the Inaugural Address." See also Richard Gardner, *Sterling-Dollar Diplomacy in Current Perspective: The Origins and the Prospects of Our International Economic Order,* New Expanded Edition (New York: Columbia University Press, 1980), 76. New York City as the "temple of finance" of *Pax Americana* is well documented and needs not be repeated here. For details, see Langley, *World Financial Order*; Germain, *The International Organization of Credit*; Edwards, *Evolution of Finance Capitalism*.

being offered" for sale so that the potential investor could make an informed decision.[115] The Securities Exchange Act of 1934 is primarily about trading in securities on organized exchanges over-the counter markets. It empowers the SEC to regulate trading as well as activities of exchange officials, brokers, dealers, and speculators.

In essence, the New Deal planners made finance truly the "servant, not the master, of human desires—in the international no less than in the domestic sphere."[116] They established structures that coordinated sovereign credit with domestic financial flows. They placed emergency embargo on payments of gold within and outside the country, devalued the dollar by purchasing gold, and then fixed the dollar-gold exchange rate at $35 an ounce.[117] In effect, they promoted social regulation of the free market system. As John Ruggie pointed out, the New Deal "ideology and doctrine" did not "exist in a social vacuum;" market rationality was determined by prevailing social relations. He calls this version of capitalism "embedded liberalism."[118]

Embedded liberalism is the planned or mixed version of liberal capitalism. It differs from both classical and neoclassical liberalism in terms of its social embeddings. It was the American version of Keynesian liberal industrial welfare capitalism. To emphasize its social embeddedness, Ruggie quotes Karl Polanyi's famous statement:

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[115] James S. Landis, "The Legislative History of the Securities Act of 1933," *George Washington Law Review*, 29 (1959-1960), 34. See also Edward N. Gadsby, "Historical Development of the S.E.C—the Government View," *George Washington Law Review*, Vol. 28, No. 6 (1959-1960), 9. The "information disclosure" requirement of the Securities Act marked the beginning of regulatory coordination of securities investments in the U.S. The information disclosure clause was based on British Companies Act of 1844.

[116] Richard Garder, *Sterling-Dollar Diplomacy in Current Perspective*, 76; Eric Helleiner, *States and the Reemergence of Global Capital*, 3; Quoted in Eric Helleiner, "When finance was the servant," 20. See also Craig Murphy (Review Author), "Can Finance Be Made Servant Again?" 332.

[117] Odell, U.*S. International Monetary Policy*, 74.

[118] Ruggie, "International Regimes, Transactions, and Change," 382-386

"*Laissez-faire* was planned." In fact, John Ikenberry describes embedded liberalism euphemistically as the "American system" or "welfare state liberalism."[119] In this model of capitalism, the state serves as the main regulator and enforcer of fundamental financial policies and monetary values. The production and distribution of strategic public goods, including financial instruments is its preserve. This model, in effect, reflects the relative efficiency of political and market institutions; it harmonizes both ends of the spectrum.[120]

Evidently, a marketplace relation in both the New Deal and embedded liberalism can be seen in the Securities Exchange Act of 1934. The law was passed in the interest of the nation, although the investment and banking communities generally opposed it. It was a marketplace relation because the initial controversies generated by both the 1933 and 1934 legislations subsided with time. As Milton Freeman pointed out, by 1941 the financial industry authorities and Securities Exchange Commission regulators "were sitting in joint meetings to consider amendments" of the two acts.[121] Consideration of amendments means that although disagreements over key elements of the laws remained, their practical administration "received increasing acceptance" among the regulated entities.[122] Writing in 1960, Freeman notes:

> During the course of these twenty-five years, as the financial community has become accustomed to the regulations and to the Commission, acceptance of the statutes and of the Commission's rules under them has been growing. … [A] very *substantial part of the reason* for this acceptance and for the success of the

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[119] Ikenberry, "Rethinking the Origins of American Hegemony," *Political Science Quarterly*, Vol. 104, No. 3 (Autumn, 1989), 376.

[120] Cerny, *The Changing Architecture of Politics*.

[121] Milton V. Freeman, "A Private Practitioner's View of the Development of the Securities and Exchange Commission," *George Washington Law Review*, Vol. 28, No. 18 (1959-1960), 19.

[122] Freeman, "A Private Practitioner's View," 19.

> Commission in accommodating itself to changing conditions has been the constant policy of the Commission, since its earliest days, of *consultation* with the industry and with the bar. Even during the bitterest days of the Holding Company Act battles, the Commission staff and industry *never broke off consultations*, although prospect of accommodation at times seemed dim…(emphasis added).[123]

This quote presents unambiguous evidence of the marketplace framework—pragmatic regulatory coordination. The key element is regulatory authorities' proclivity as well as market authorities' preferences for "consultation" on matters of common interest and substantial disagreement, despite the "tremendous discretionary power" of the SEC. The securities acts "specifically provide for judicial review of findings and rulings in certain cases," but both the SEC and the financial industry made limited use of the court review process. They did so not only because of the "practical difficulty in obtaining review by an impartial body in time in most cases but the circumstances under which such would permit effective relief."[124] Consultation gives us a clear idea of the marketplace relation, which is the mutual, systemic benefits of coordination involving regulated bodies and regulatory entities. Consultation is a practical mark of pragmatic regulatory coordination. Consultation is necessary because a shared burden requires coordinated management.

Through regulatory consultation/coordination, the work of the SEC helped to restore the "shattered public confidence" in financial markets while elevating "the moral tone" of the industry.[125] Having worked well in the American context, the marketplace framework was extended onto the world stage in the waning years of World War II. The global economic conditions of the interwar period necessitate it. In other words, the

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[123] Freeman, "A Private Practitioner's View," 20.
[124] Freeman, "A Private Practitioner's View," 22.

[125] Freeman, "A Private Practitioner's View,"18.

"American system" or New Deal framework became the substratum of the Bretton Woods system—a substratum I call embedded liberal internationalism.[126]

7. CONCLUSION

This chapter explores the historical contexts of the marketplace framework by focusing on the development of financial governance in the two advanced liberal capitalist states. It identifies and assesses de jure and de facto policies, statutes, political actions and social reactions that brought about such governing philosophy. Such includes establishing and nurturing trading exchanges, setting up central bank charters, providing sound medium of exchange and uniform currencies, legislating corporate deeds of settlements, nurturing joint stock companies, institutionalizing monopolistic credit institutions, and creating clearing houses for domestic/international payments systems. Others include designing conditions and mechanics to attract foreign capital investments, enforcing property rights, and guaranteeing private loans to sovereign powers and non-sovereign entities alike. The rest includes establishing regulatory agencies and public debt management systems, and cordial relationships between political authorities and financial markets entrepreneurs.

These policy choices and processes show that financial governance in both states is a mixture of private and public affairs. The measures, mechanisms and processes are informal, indirect, flexible, and pragmatic in nature, content and form. They illuminate how the liberal economy—trade and finance—are *designated* by law and reinforced by politics and public policy as a 'self-regulating' realm *separate* from the liberal state. The

[126] I derived "embedded liberal internationalism" from Ruggie's "embedded liberalism," which he coined to describe the "compromised liberalism" between finance and labor after World War II. I use the term with apologies to him. To me, "embedded liberalism" echoes the New Deal politics of the U.S. more than it refers to postwar international system, although both are characterized by Polanyian concept of double movement. In other words, "embedded liberalism" seems to be domestic-focused more than embedded liberal internationalism. My concept, however, does not take away the essence of Ruggie's.

process of designation may be definitive or indeterminate, and may lack specificity and fixed principles. Although the 'designation' defines the liberal state and its financial markets in antipodean terms, the governing philosophies *unnecessarily isolate* the capitalists and their credit resources from their respective governments.

All told, the governing principlesare expedient and pragmatic and reflect Huntington's concept of the "power paradox." Nowhere in the governing system is the power paradox more evident than in the central banks. They are structurally embedded political institutions performing financial/economic functions. Their policies are critical for the functioning of the marketplace framework. In a sense, they are the 'wily foxes' in the rear of the marketplace framework. Stated in other words, they are the bellows of the market economy. They sustain credit organization, hold reserves of banks and other financial institutions, serve as the lenders of last resort, act as clearing houses across transnationalized marketplace, and hold financial connections and affiliations around the world. It is through them that financial policies are channeled to fan development and growth of the liberal capitalist states, and by extension, the global political economy. Finance is the *means* specific to these states. Hence, its effective management generates the enduring confidence of the marketplace.

The chapter concludes that the liberal governing philosophies are never a *given*, but rather a coordinated political endeavor. The supposed tension between the state and market is what their coordinated relations make of the international political economy. The lack of understanding of the pragmatic regulatory coordination still makes populist critics, including historical figures such as the rabble-rouser Mary E. Lease to believe that the U.S. government, for instance, is/was "no longer a government of the people, by the people and for the people but a government of Wall Street, by Wall Street, and for Wall Street."[127] What these need to understand is that finance is at the core of governmental rationality in the advanced liberal capitalist state. A glance at history reveals this synergic relationship.

[127] Quoted in Edwards, *The Evolution of Finance Capitalism*, 190.

CHAPTER 6

THE MARKETPLACE FRAMEWORK IN CONTEMPORARY CONTEXT

> [T]he rulers of the exchange of mankind's goods have failed through their own stubbornness and their own incompetence, have admitted their failure and abdicated. Practices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men.
>
> True, they have tried, but their efforts have been cast in the pattern of an outworn tradition. Faced by failure of credit, they have proposed only the lending of more money. Stripped of the lure of profit by which to induce our people to follow their false leadership, they have resorted to exhortations, pleading tearfully for restored confidence. They know only the rules of a generation of self-seekers....
>
> The money changers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths. The measure of the restoration lied in the extent to which we apply social values more noble than mere monetary profit.
>
> – President Franklin D. Roosevelt[1]

> If for any reason—and God grant it may never be so—these boards of control [in the 12 Federal Reserve Banks and the Board of Governors] should lack the wisdom and courage to do their duty, we would still be subject to all the disasters that now befall us, because of the fact that the *control is not wisely exercised*.
>
> –Rep. Charles Korbly[2]

1. INTRODUCTION

These statements—made almost twenty years apart—reflect the uncertainty of credit organization and the need for pragmatic regulatory coordination. That of Congressman Charles Korbly (published on September 10, 1913) is part of a Congressional debate on

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[1] Roosevelt, "Text of the Inaugural Address."

[2] Quoted in Richard H. Timberlake, "Institutional Evolution of Federal Reserve Hegemony," Cato Journal, Vol. 5, No. 3 (Winter 1986), 743.

establishing the Fed. It shows his concern about potential political and social impacts of institutional failures of monetary management. FDR's is from his first inaugural speech, dated March 5, 1933. Both quotes stress pragmatic harmonization of credit organization.

Specifically, the times and contexts of the two statements echo the causes as well as political reactions to the 2008 financial crisis. In both cases, officials of the temples of finance admitted the flaws of the principles that guided their credit organization and have asked for re-regulation of financial market institutions.[3] Indisputably, such admissions discredited the prevailing frameworks for organizing the political economy. In the contemporary case, public confidence and trust—the fundamentals of the marketplace framework—are still being restored to the ancient truth of the visible hands of politics. To paraphrase FDR, the true measure of restoring those fundamentals lay in pragmatic harmonization of financial market operations and social values.

It is in the framework of restoring politics and finance to their cognate functions that this chapter examines the contemporary marketplace framework. It draws upon the processes that led up to the 2008 crisis, analyzes transnational policy interventions that subdued the crisis from tipping the global economy into depression and reviews ongoing policy initiatives to stimulate the economy. The chapter highlights domestic, intra-agency, and cross-country institutional regulatory coordination in the two advanced liberal states. Tangential policy supports from other countries are referenced where necessary to explain procedurally coordinated and integrated marketplace framework.

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[3] For contemporary admissions, see Andrews, "Greenspan Concedes Error on Regulation;" Chan, "Greenspan Concedes that the Fed Failed to Gauge the Bubble;" Editorial, "Who is Not Sorry Now," *New York Times*, April 11, 2010; Alan Greenspan, "The Crisis Comments and Discussion," *Brookings Papers on Economic Activity* (Spring 2010).

The contemporary perspective starts from the post-World War II international monetary order,[4] for three reasons. First, the roots of the 2008 crisis stem from the collapse of that order's fixed exchange rate regime. Second, as John Ikenberry put it, the postwar monetary system was unlike anything the capitalist world had seen before. Its open multilateral trading and payment system reconciled "trade expansion with the commitments of national governments to full employment and economic stabilization."[5] Third, the rules and regulations of that order were designed and constructed by U.S. with 'reluctant' political support from Britain. Importantly, that order and the current floating exchange rates system are Anglo-American in origin and shape. Moreover, both states are epicenters of the 2008 crisis. It is for these reasons the Bretton Woods order provides the best setting for analyzing contemporary marketplace framework. A glance at history reveals the origin of regulatory and deregulatory policies that led up to the 2008 crisis.

It is vital to emphasize that regulatory, deregulatory, and re-regulatory policy and processes are reflections of the marketplace framework. There is causality between deregulation and internationalism because the fixed exchange rate regime and the floating exchange rate system are creatures of the two principal states being examined.

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[4] According to Cohen an international monetary *order* is the framework of rules and regulations as well as conventions and norms that govern the external financial conduct of nations. Robert Mundell distinguishes a "monetary system" from a "monetary order" by defining the former as "an aggregation of diverse entities united by regular interaction according to some form of control." In other words, international monetary order is about the rules and standards that regulate trans-border financial conduct while international monetary system is about entities and agencies in the monetary order. There is a first order relationship between "order" and "system." See Benjamin J. Cohen, *Organizing the World's Money: The Political Economy of International Monetary Relations* (New York: Basic Books, 1977), 3.

[5] Ikenberry, "A World Economy Restored," 289. Richard Gardner observed earlier that the uniqueness of said monetary order was a "miracle" in the sense that it had no historical precedent. For details, see Richard N. Gardner, "Sterling-Dollar Diplomacy in Current Perspective," *International Affairs*, Vol. 62, Issue 1 (Winter 1985/86), 21.

2. BRETTON WOODS MONETARY SYSTEM: EMBEDDED LIBERAL INTERNATIONALISM

I noted earlier that the U.S. emerged from World War II as the strongest nation in the world because the collective strength of pre-war competitors fizzled away. The country's power was simply unmatched, and it replaced Britain as the hegemon, with the rules and standards of the postwar international system shaped and based on its own values.

In fact, having come to terms with the reality of finance as a strategic industry too important to be left to the logics of markets alone,[6] the "postwar consensus" established the Bretton Woods monetary system in a way that 'caged' financial activities. The negotiation process was burdened with disagreements between political authorities and financial market actors. John M. Keynes and Harry D. White, the principal negotiators, faced difficulties with their original proposal, which sought to significantly constrain financial markets. Their plan for the international payment system did not have any provision for short-term private capital movement. Such was recognition of the fact that short-term private credit movements destabilized the world economy of the twenties, caused the stock market crash of 1929, and led to economic depression of the 1930s.

The plan would allow countries to control the international payment adjustment mechanism through the International Clearing Union (ICU). The ICU would determine foreign exchange values of countries with balance of payment problems by injecting liquidity it would create, which meant that the international payment adjustment method would depend on public capital transactions. Such was deemed necessary to bring deficit

[6] As I indicated earlier, lessons from the New Deal politics were useful in reconstructing the postwar world order.

countries into equilibrium with the world economy.[7] But New York banks opposed it on grounds that short-term foreign capital inflows were the most important sources of their deposits. The planners prevailed, though without the ICU mechanism. They replaced the gold standard payment with dollar-gold exchange rate system, which allowed the U.S. to effectively alleviate postwar dollar shortage and provide international liquidity.

Embedded liberal internationalism was structured on two interlocking continuum. On one end was an open liberal competitive ideology of free trade in goods and services. On the other end was the Keynesian doctrine of capital control. In other words, the system was a blend of liberal ideology of open-ended trade and the doctrine of financial regulation. In essence, the Bretton Woods monetary order was established to achieve the duopoly of promoting as well as regulating an open liberal world economy.[8] The dualism was necessary to guarantee participation and policy autonomy of the new welfare states in a liberal international trading system. The IMF stabilized international exchange rates as well as provided long-term sovereign credit to new states to enable them protect and expand their domestic institutions and productive capabilities. In other words, the IMF was endowed with both restrictive and cooperative control mechanisms with which it regulated speculative, unproductive and abnormal capital flows within the international

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[7] I. de Vegh, "The International Clearing Union," *The American Economic Review*, Vol. 33, No. 3 (September 1943), 535. See also de Cecco, "International Financial Markets and US Domestic Policy since 1945," 382; Takekazu Iwamoto, "Keynes Plans for an International Clearing Union Reconsidered," available from http://repository.kulib.kyoto-u.ac.jp/dspace/bitstream/2433/56821/1/ece001_178.pdf (accessed March 10, 2010), 179.

[8] The duopoly reflects Polanyian "double movement"—a countermovement of trade and finance in the international relations. For details, see Karl Polanyi, *The Great Transformation: The Political and Economic Origin of Our Time*, Foreword by Joseph E. Stiglitz with a New Introduction by Fred Block (Boston: Beacon Press, 2001/1944), 136. See also Beverly J. Silver and Giovanni Arrighi, "Polanyi's 'Double Movement': The *Belle Époques* of British and U.S. Hegemony Compared," *Politics & Society*, Vol. 31, N. 2 (2003): 325-355.

system.[9] Ikenberry calls this system a "blend of laissez-faire and interventionism—of liberal multilateralism and the welfare state."[10] Helleiner describes it as "a multilateral order in which the capital controls and financial interventionism of the 1930s could be consolidated."[11] For Ruggie, it was a "compromise" regime for free trade and financial control—a compromise unlike the monetary and economic nationalism of the 1930s and the gold standard payment.[12] In other words, embedded liberal internationalism was a negotiation between regimes for international trade and international finance. Such was necessary because it was strongly believed that liberal international trade was opposed to international finance.[13] As Cerny put it, that system was designed to prevent capitalist rivalries for financial nationalism characteristic of the roaring twenties.

The marketplace framework in this context is that the Breton Woods monetary system was designed to adjust to domestic as well as international economic and political stability. The financial base being crucial was tucked under hegemonic structures in a multilateral setting. The catastrophic impact of interwar financial crises and postwar economic disequilibrium necessitated this structural design, a design that harmonized social values with private financial interests. In that scheme of things, the state was the regulator and enforcer of economic and financial decisions. Production and distribution

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[9] Cerny, "The Deregulation and Re-regulation of Financial Markets in a More Open World," 54; Helleiner, *States and the Reemergence of Global Finance*, 3; Langley, *World Financial Orders*, 66.

[10] Ikenberry, "A World Economy Restored," 294.

[11] Quoted from Craig Murphy (Review), "Can Finance Be Made Servant Again?" 332.

[12] Ruggie, "International Regimes, Transactions, and Change," 393. David Harvey argue that embedded liberalism was "a sort of class compromise between capital and labor," which was deemed necessary "to ensure domestic peace and tranquility" and to "prevent the re-emergence of inter-state geopolitical rivalries." See Harvey, *Neoliberalism: A brief History*, 4.

[13] Helleiner, *States and the Reemergence of Global Finance*, 5; 20.

of public goods were its preserve. It intervened in the economy on a regular basis to keep the world economy sound. These measures were necessary to bring life back into the world economy in general, and financial markets in particular. Overall, the system was critical for harmonizing private interests and social goals of each state.

Embedded liberal internationalism was, thus, a marketplace framework par excellence. First, it provided a structure within which collaborative relations between political authorities, organized labor, and market institutions were conducted. Within that structure, the state protected markets and at the same time ensured that workers received rising wages.[14] Second, the model was generally accepted by politicians of all brands and persuasions (liberals and conservatives of Left, Right and Center leaning) and market actors in capitalist states as the best for economic growth, business management and national development. Third, it was adopted by newly independent states as they sought to fulfill social and economic needs of their people. Lastly, the fact that it functioned under capitalist hegemony gives it marketplace validity. After all, the marketplace framework is a liberal capitalist phenomenon.

In spite of its broad acceptance, the seeds of decline and collapse were structurally inherent in the nature of the model itself. Part of the structural imbalance stems from the fact that the system allowed states with well organized financial market institutions to pursue balance of payment deficits, which in essence, is a marketplace phenomenon. Scholars generally agree that the U.S. was able to pursue balance of payment deficits from the 1960s because of the intermediatory roles of New York financial institutions,

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[14] Allan G. Gruchy, "Uncertainty, Indicative Planning, and Industrial Policy," *Journal of Economic Issue*, Vol. 18, No. 1 (March 1984), 168-169.

and the fact that the dollar is the international reserve currency. This explains why President John Kennedy's administration showed no hostility toward U.S. financial market institutions, particularly the large ones in New York City. The government's policies were considered "favorable" towards them. That is because Kennedy and his appointees understood the nature of the marketplace relations, which is that finance is the substratum of the state. The country's domestic social and economic agenda as well as its external policy of containing the Soviet menace could be pursued only in a pragmatic coordination with financial structures. In the Soviet case, the administration deemed it necessary to consolidate U.S. financial and monetary leadership in Western Europe.[15] And it did so in a variety of ways, including the opening of Eurodollar markets.

The Eurodollar markets reveal overlapping, cross-country marketplace relations between U.S. and Britain and their financial market institutions (we shall return to this in greater detail). Suffice it to say that because those markets allowed foreigners to hold assets in dollar denominated values, they made it possible for Wall Street institutions (with U.S. government's blessing) to reverse the flow of dollars into Europe. Such was the case because Kennedy administration's 'stiffening' of interest rates[16] made time deposits of New York market institutions competitive in vis-à-vis U.S. Treasury securities and Eurodollar values. That enabled more dollars to flow back to the U.S. As I pointed out in the first three chapters, interest rate management—the glue of the market system—is a function of pragmatic regulatory coordination. In other words, the price of credit and supply of money depends on interest rates policy.

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[15] de Cecco, "International Financial Markets and US Domestic Policy since 1945," 387.

[16] de Cecco, "International Financial Markets and US Domestic Policy Since 1945," 390.

Additionally, the marketplace relations during the Kennedy era were evident in policies pursued by the Office of Comptroller of the Currency. James J. Saxon, head of the agency (1961-1967), designed an "extremely lenient" regulatory approach toward the banking industry. Saxon served in prominent positions prior to his appointment. For instance, he was assistant general counsel to the American Bankers Association. He also served as attorney for the First National Bank of Chicago. Being an ex-banking authority, he found it quite natural to help banks expand their investment and lending powers, even when such contradicted Federal Reserve policies. As he explained before Congress, his goal was to reduce the image of national banking from being a closed industry. One of the primary things he did in that regard was allow Wall Street banks to open markets for a new credit instrument known as Negotiable Certificate of Deposit. The First National City Bank created this time deposit, a credit instrument with positive interest advantage over Treasury Bills and commercial papers. Although a time deposit, large institutional depositors were permitted to receive market rates for it. Because of this advantage, Wall Street discount houses created secondary liquid markets to facilitate its transaction.[17]

The attractiveness of the time deposit made the international financial system quite unstable. It allowed short-term depositors from around the world to shift between alternative assets, which led to massive disintermediation of American banking system.[18]

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[17] Eugene N. White, *The Comptroller and the Transformation of American Banking, 1960-1990* (Washington, D.C.: Comptroller of Currency, 1992), 9-11. James J. Saxon, "Bank Expansion and Economic Growth: A New Perspective," *The Anti-Trust Bulletin*, Vol. 8, Issue 4 (August, 1963): 597-605; George W. McKinney, Jr. "New Sources of Bank Funds: Certificates of Deposit and Debt Securities," *Law and Contemporary Problems*, Vo. 32, Issue 1 (Winter 1967), 71-99.

[18] de Cecco, "International Financial Markets and US Domestic Policy Since 1945," 390. For financial innovation in the 1960s, see William L. Silber, "The Process of Financial Innovation," *American Economic Review*, Vol. 73, Issue No. 2 (May 1983): 89-95.

Saxon, however, succeeded in liberalizing banks from contractual engagements they were not permitted to undertake previously. His success was evident in the growth of banks during his tenure of office. He approved 437 new charter banks in his first year alone, far more than the 237 approved in the year before his appointment. By the time he left office, he had permitted large banks to operate in new areas of the financial industry such as mutual funds, insurance premiums, stockbrokerage, and investment funds. Those innovations marked the beginning of globalization of finance. Considered in this light, the dynamism of financial liberalization seems to have conflicted with the missions of state banks, federal banking regulators, and the SEC as a consolidated regulator. But it is not; the marketplace relation in this sense is concurrently regulatory and deregulatory.

All things considered, the Kennedy administration pursued those polices because it inherited external payments imbalance and a domestic recession. It tackled both with fiscal and interest rates policies. As I noted earlier, the interest rate policy was favorable to domestic financial market institutions because it allowed them to reverse capital flow (the main cause of U.S. balance of payment deficits) from Europe. They benefitted from the rate differentials between the U.S. and other financial centers them. The marketplace relation is clear in this regard: both U.S. political and financial establishments benefited.

There is no doubt that Britain also benefited from Eurodollar markets. After its government abandoned sterling denominated third party foreign trade financing in 1957, U.K. financial markets traded in dollar deposits from New York. Britain lost such privileges when Eurodollar market operations were reversed. But then, the seeds of financial re-globalization had already been planted, out of which its credit market institutions hold a special place. The next section examines the end of the fixed exchange rate system and the marketplace framework as revealed by financial re-globalization.

3. THE COLLAPSE OF THE FIXED EXCHANGE RATE SYSTEM

Notwithstanding the benefits of embedded liberal internationalism—in terms of the long boom and relative world economic stability—the system began to decline soon after it was established. A number of factors explain it. Susan Strange summarizes them as "distant non-decisions" with extensive political implications for the hegemon.[19] Those factors hinged on the adjustable exchange rate, the *fulcrum* that kept the monetary system together. The hegemon's ability and willingness to guarantee the dollar-gold exchange standard was the system's foundation. In other words, the system's resilience hinged upon the hegemon's capability and commitment to defend it, maintain an open market for distressed goods, guarantee the value of the dollar in gold, and act as the lender of last resort to free balance of payment constraints.[20] That level of commitment was necessary to reduce potential policy divergence between states. The system would collapse if and when the hegemon decided to withdraw its obligations. That exactly happened when the Nixon administration unilaterally withdrew U.S. support in 1971.

The unilateral abrogation was the result of a number of converging events, which put pressure on the dollar for devaluation. They include massive U.S public spending beginning with European Recovery Program, the Korean War of 1950 and the Vietnam

[19] Susan Strange, *Mad Money: When Markets Outgrow Governments*, 5.

[20] Germain, *The International Organization*, 95; Cerny, "American Decline," 165. Odell, *U.S. International Monetary Policy*, 35-36; Cohen, *Organizing the World's Money*, 221.

War.[21] Others include the petroleum crises of the 1970s and recycling of "petrodollars"[22] around the world. Those interlocking processes affected the hegemon's ability to provide needed degree of international credit without undermining the adjustable exchange rates regime. They complicated the hegemon's economic preponderance shifted the economic order structurally.[23] In effect, they created what Robert Triffin calls the "gold and dollar crisis"—a crisis that led to eventual collapse of the world financial architecture.[24]

The gold-dollar crisis occurred because the increasing change in world economy between the 1950s and 1960s—resulting from European and Japanese recovery as well as the rapid improvement in their reserves—shifted the structure of American economic surplus to a growing deficit. While the U.S. was increasingly adding to its negative current account as a result of its foreign policy goals, its closest competitors were strengthening their capital accounts by holding American dollars guaranteed in gold.[25] These development exacerbated U.S. balance of payment deficits and resulted eventually

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[21] Lee E. Ohanian, "The Macroeconomic Effects of War Finance in the United States: World War II and the Korean War," *The American Economic Review*, Vol. 87, No. 1 (March 1997): 23-40.

[22] See Susan Strange, *Mad Money*, 7. See also J. Orlin Grabbe, *International Financial Markets*, 2nd ed. (New York: Elsevier Science Publishing, 1991), 11.

[23] Keith Hartley and Todd Sandler, "NATO Burden-Sharing: Past and Future," *Journal of Peace Research*, Vol. 36, No. 6 (November 1999): 665-680; Ikenberry, "Rethinking the Origins," 376. See also Odell, *U.S. International Monetary Policy*, 7, 115; Strange, *Mad Money*, 5.

[24] Robert Triffin, *Gold and the Dollar Crisis: Yesterday and Tomorrow* No. 132 (Princeton: Princeton University Press, 1978), 1-3. See also Germain, *The International Organization of Credit*, 7, 97. In addition to these factors was European's refusal to share NATO defense burden equitably with the hegemon even though U.S. military presence in Europe was somewhat "by invitation." European political leaders decided to "free-ride' on U.S. security guarantee against the Soviets while nurturing their respective welfare states into postwar recovery. See also Geir Lundestad, *The United States and Western Europe Since 1945: From "Empire" by Invitation to Transatlantic Drift* (Oxford: Oxford University Press, 2003).

[25] John S. Odell, *U.S. International Monetary Policy*, 112-124. See also Strange, *Mad Money*, 5, and *Casino Capitalism*, 6.

in a "dollar glut" or "dollar overhang," as Triffin calls it. The dollar shortage came as a result of U.S. inability to "convert dollars into gold" at $35 an ounce upon demand.[26] This problem, the "Triffin Dilemma," centered on the idea that any attempt on the part of the U.S. to reduce or eradicate its current account deficits would compromise its ability to provide sovereign credit necessary to hold the system together.

The earliest cause of the "dollar glut" is best explained via the marketplace framework. It all began in the 1960s when the City of London reopened as a partner to Wall Street in transnational credit organization. U.S. and U.K. governments supported the growth of Euromarkets as offshore regulation-free location in which trade in financial assets denominated in U.S. dollar, dominated.[27] The alliance between Washington and London, and between Wall Street and the City of London, was fundamental in the creation of the Euromarkets. That marketplace relationship marked the beginning of financial liberalization, which intensified in the 1970s 1980s through competitive deregulation and reached peak season following the fall of the Soviet Union.[28]

Thus, Eurodollar markets are vital in explaining financial globalization. While U.S. banks dominated these markets, Britain regarded them as a channel for international

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[26] Triffin, *Gold and Dollar Crisis*, 2; Thomas Oatley, *International Political Economy: Interests and Institutions in the Global Economy* (New York: Peason/Longman, 2004), 237-246.

[27] According to Helleiner, the Euromarkets were the "'adventure playground' for private international bankers." See Heleiner, *States and the Reemergence of Global Finance*, 8, 12; Susan Strange, *Mad Money*, 6; *Casino Capitalism*, 6-7; Kane, *The Eurodollar Market and the Years of Crisis*; Dennis P. Quinn and Carlan Inclán, "The Origins of Financial Openness: A Study of Current and Capital Account Liberalization," *American Journal of Political Science*, Vol. 41, No. 3 (July 1997): 771-813; Spindler, *The Politics of International Credit*, 186-187.

[28] Helleiner, "When finance was the servant," 38-39; Gerald Caprio, Patrick Honohan and Joseph E. Stiglitz, eds., *Financial Liberalization: How Far, How Fast* (Cambridge: Cambridge University Press, 2001), Ronald I. McKinnon, "Financial Control in the Transition from Classical Socialism to Market Economy," *Journal of Economic Perspective*, Vol. 5, No. 4 (Fall 1991):107-122.

capital to reinvigorate its traditional role of providing the world economy with liquidity.[29] As there was virtually no interest or exchange rate control in place, market participants in both countries as well as other governments seeking funds for developmental projects, large public sector firms and OPEC member countries were attracted to the Eurodollar markets. They either borrowed from those markets or invested capital in them. This development led to new competitiveness for financial capital via expansion of international trade and corporate activities. The competitiveness exerted pressure on American capital markets and institutions to expand for more unregulated outlets.[30]

In short, the Eurodollar markets undermined the significance of the restrictive financial regime of the early postwar years. U.S. inability to reinforce the dollar's defense in the face of the new financial competition undermined the dollar' stability, the monetary system and American hegemony. The hegemon not only dismantled its own capital control programs, the Nixon administration opposed cooperative initiatives, withdrew U.S. interventionist role from foreign exchange markets and encouraged other governments to abolish the adjustable exchange rates system.[31] That decision led revived 'high finance' based on floating exchange rates and competitive deregulation. It shifted

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[29] Cerny, "Deregulation and Re-regulation," 58. See also Milton Friedman, "The Euro-Dollar Market: Some First Principles," Selected Papers, No. 34, Morgan Guaranty Survey (1969), available from http://www.chicagobooth.edu/faculty/selectedpapers/sp34.pdf (accessed 04/10/2010).

[30] Cerny, "The Deregulation and Re-regulation," 58.

[31] Susan Strange, *Casino Capitalism* (New York: Basil Blackwell, 1986); Odell, *U.S. International Monetary Policy*, 165-169. Strange describes Nixon's decision as a "deliberate act of sabotage" because U.S. cooperation (or coordination) was necessary to sustain the adjustable exchange rates system, given its continuing preponderance in the international system. See Strange, *Mad Money*, 6.

embedded liberal internationalism towards a neoliberal, deterritorialized financial system in which actions and inactions of political authorities are negotiated.[32]

In fact, intellectual discussion of political Washington's decision to withdraw support for the Bretton Woods monetary system is not conclusive. Scholars hold quite divergent views. Some argue that the system's breakdown was entirely an issue of American mismanagement. Others assert that the economic difficulties of the late 1960s and early 1970s as well as the continuing frustrations that global businesses and markets encountered, particularly with regard to capital control, put significant pressure on the Nixon administration to abolish the fixed exchange regime. Still others write about it as a necessary ideological shift to promote efficiency, discipline states and "impose sound monetary and fiscal policies as well as choose regulatory and tax policies that encourage business success."[33] Cerny argues that American financial hegemony was indispensable only as a "*conjunctural* factor," for U.S. hegemony was necessary in the early postwar period as a transitional measure to help restore the health of domestic and international economies. Thus, in the long-run, the system was destined to collapse to enable the reemergence of floating exchange rates. That is to say that the monetary order and the nationally based financial systems contained structural tensions that contributed to the eventual re-globalization of finance. Cerny argues further that the ultimate system is the

[32] The competitive deregulated economy is where the sovereignties of the "Third World" states were restructured. That happened at the crossroads of financial globalization and neoliberal market governance. For details, see Jochnick and Preston, eds., *Sovereign Debt at the Crossroad*; John D. Montgomery and Nathan Glazer, *Sovereignty under Challenge* (New Brunswick (NJ) and London: Transaction Publishers, 2002); Rodney Bruce Hall and Thomas J. Biersteker, eds., *The Emergence of Private Authority in Global Governance* (Cambridge: Cambridge University Press, 2002, reprint 2004).

[33] See Nigel Lawson, quoted in Helleiner, "When Finance was the Servant," 39; Ikenberry, "Rethinking the Origins of American Hegemony," 375. See also Triffin, *Gold and Dollar Crisis*, 1; Robert Brenner, *The Boom and the Bubble: The US in the World Economy* (London and New York: Verso, 2002).

"transnational integration and competitive deregulation/re-regulation of financial markets themselves" brought about by revolution in communications technology.[34] Ruggie makes a similar structural argument by asserting that even attempts to "construct international economic regimes in the interwar period did not fail because of the lack of a hegemon. They failed because, even had there been a hegemon, [the system] stood in contradiction to the transformation in the mediating role of the state between market and society."[35] In that sense, the second financial revolution was an inevitable consequence of the structural contradictions built into the postwar monetary system.

In any event, the welfare state failed to respond adequately to unemployment and labor tensions. In the background was the notion of monetarism—the belief that the stability of an economy has a relationship with the quantity of money in circulation.[36] State actors were faced with new challenges, all of which fed into their particular, yet transnationalized, interlocking realms. When the governments of Prime Minister Thatcher and President Reagan, respectively proclaimed market reform alternative ideology to the Keynesian national economic planning,[37] the stage was set for the transformation of politics itself. The transformation was enhanced by collapse of the

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[34] Cerny, "The Political Economy of International Finance," 15; Cerny, "American Decline," 156, 157, 165; On "*conjunctural* factor," see Cerny, "The Political Economy of International Finance," 14 (emphasis is original). See also Germain, *International Organization of Credit*, 25. John Cantwell, "The Changing Form of Multinational Enterprise Expansion in the Twentieth Century," in *Historical Studies in International Corporate Economy* ed. A. Teichova (New York: Cambridge University Press, 1989).

[35] Ruggie, "International, Regimes, Transactions, and Changes," 392.

[36] Helleiner, *States and the Reemergence*, 125; Smith, *The Rise and Fall of Monetarism*.

[37] Allan G. Gruchy, "Uncertainty, Indicative Planning, and Industrial Policy," *Journal of Economic Issues*, Vol. 18, No. 1 (March 1984), 159. See also Helmut Norpoth, *Confidence Regained: Economics, Mrs. Thatcher, and British Voter* (Ann Arbor: University of Michigan Press, 1992); Herbert F. Weisberg and Charles E. Smith, Jr., "The Influence of the Economy on Party Identification in the Regan Years," *The Journal of Politics*, Vol. 53, No. 4 (November, 1991): 1077-1092.

Soviet Union and subsequent election of quasi-socialist turned neoliberal reformist politicians. These developments positioned global financial markets of developed capitalist states to take the lead in reorganizing social relations across political realms. The political logic of these structural changes was the finance-driven Competition State model which, paradoxically, is a regulatory and a deregulatory entity.[38]

4. CORE MARKETPLACE RELATIONS IN EMBEDDED LIBERALISM

The marketplace framework is evident in embedded liberal internationalism on three other levels. First, the embeddedness of the monetary system hinged on the structures of finance. The 'caging' of finance in an open multilateral trading system—a blend of free enterprise and the interventionism—is the true mark of the marketplace framework. It synchronized private ends with public policies. Harmonization ensured that finance and politics work in the interest of each other. That is what the marketplace framework is about. Second, the multilateral character of the postwar system made it possible for investment finance to spread across sovereign states. States cooperated in mutually reinforcing ways not necessarily because of the hegemon, but because pragmatic regulatory coordination made cooperative behavior possible. Third, Euromarkets reveal coordination between the two liberal capitalist states and their credit institutions working together in pursuit of one another's interests. Such were cooperative arrangements to generate new competitiveness for financial capital to solidify liberal political power.

Although the Euromarkets undermined the restrictive character of the postwar monetary order, the eventual collapse of the fixed exchange rate system, Strange argues,

[38] See Cerny, *The Changing Architecture of Politics*; Cerny, "Paradoxes of the Competition State;" Cerny, "Political Globalization and the Competition State;" Cerny, "The Competition State Today."

was the result of the hegemon's political decisions. Whether such was a strategic move or whether it was forced by the changing international economic structure, the decision itself was a "selective incentive" in the interest of politics and finance in advanced liberal capitalist states. Considered from this angle, globalization of financial markets is not self-generating; it is the product of actions and inactions of powerful, resource-based advanced liberal capitalist countries. As Cerny argues, financial globalization requires transformation of the welfare state into the Competition State, which promotes and enforces globalizing norms, standards and pro-market orthodoxy.[39] Helleiner identifies three policy decisions that advanced capitalist states adopted toward transforming the welfare state. The first was their resolve to grant market entrepreneurs more freedom through competitive liberalization initiatives. The second was to refrain from impeding the flow of capital around the world economy. And the third was to prevent financial crises of significant international magnitude.[40] These policies are best understood via the marketplace framework.

These broad frameworks formed the basis of specific decisions and non-decisions of advanced capitalist states as they liberalized their credit markets. They did it with support from public international financial institutions.[41] As those institutions shaped the international financial environment, they were themselves shaped by the policies and

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[39] Cerny, "Political Globalization and the Competition State," 376; Cerny, "Paradoxes of the Competition State." Although communications technology played a major part in transforming the welfare state into a finance-driven competitive entity, technological development was not self-generating; it was part of the policy framework of advanced states.

[40] Helleiner, *States and the Reemergence of Global Finance*, 8. Susan Strange made an important argument when she pointed out that "it is very easily forgotten that 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." See Strange, *Casino Capitalism*, 29.

[41] Stiglitz, "Capital Market Liberalization, Globalization, and the IMF."

programs they forged and implemented. As Sarkis Khoury argues, globalization of financial market institutions, particularly U.S. banks, sheds light on the relation between deregulatory process and internationalism. Deregulation, thus, presents a marketplace convergence of financial and political interests of advanced liberal capitalist economies. Those processes coincided with the "Reagan Revolution" in the U.S. and "Thatcherism" in U.K. Since then, the deregulated international financial landscape has never been the same, judging by the standards and processes of its impact on governance structures in the global political economy. In short, if embedded liberal internationalism was marked by getting the "priests" out of the temple of finance, the post-Bretton Woods floating exchange system was marked by what R. T. Naylor refers to as "putting the money changers back in the temple."[42] Either way reflects marketplace framework because the essence was to make regulatory or deregulatory coordination work for political and financial structures in advanced capitalist states.

5. MARKETPLACE RELATIONS IN DEREGULATION

As I noted above, deregulation was in the interest of capitalist states and their financial market institutions. For example, Eurodollar markets revitalized London as a world financial center and strengthened successive U.K. governments. As other governments raised capital in London Euromarkets more than any financial center in Europe, U.K. gained leveraged advantage in its relations with them. The extent of the deregulatory was evident in the fact that out of 458 foreign banks operating in London in 1987, only 29 did

[42] R. T. Naylor, *Hot Money and the Politics of Debt* with Introduction by Leonard Silk (Montréal/New York and London, 1994), 77-91. See also Loriaux et el., *Capital Ungoverned: Liberalizing Finance in Interventionists States*

not own branches and subsidiaries. London truly became the leading center in world insurance, reinsurance, and shipping contracts by 1980s.[43]

In fact, the deregulatory process in the U.K was transformative in scale, process, and product. For instance, it allowed single broker dealer firms to assume the twofold functions of securities broker and securities dealer. That was the case because the barriers between risk-taking market makers and order-taking brokers were removed. The merger was preceded by the transformation of existing informal regulatory system into a private Securities and Investment Board (SIB). The Financial Services Act of 1985 created the SIB as a self-regulating body to protect private investments. To internationalize the regulatory process, the government introduced new rule in March1986, which allowed foreign investors to own 100 percent of shares of their member firms. Before then, the rule allowed only up to 29.9 percent of foreign ownership of U.K. firms.[44]

The lifting of a July 1984 moratorium on March 1, 1986, to new firms with foreign capital on the LSE is another evidence of the British government facilitating financial market processes. The suspension resulted in greater participation of foreign investment firms on the LSE, many of which were of U.S. origin. This development increased competition in the financial industry in such areas as transaction cost reductions, equity and bonds markets and liquidity creation. That is to say, political

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[43] See Sarkis J. Khoury, *The Deregulation of the Financial Markets: Myths, Realities, and Impact* (London: Printers Publishers, 1990), 125-126; Louis Pauly makes a similar argument by noting that "crossborder financial markets ultimately rest today not on private authority but on interdependent public authorities and, increasingly, on delegated public authority of international political institutions." See Louis Pauly, "Global Finance, Political Authority, and the Problem of Legitimation," in *The Emergence of Private Authority in Global Governance*, ed. Hall and Biersteker, 76-90.

[44] For details on deregulation in the U.K., see Khoury, *The Deregulation of the Financial Markets*, 129, 132-142. See also Gordon L. Clark, "London in the European Financial Services Industry," 433.

process created competitive investment environment for financial markets to operate. In this sense, competition, regulation, and deregulation are complementary processes.

Deregulatory politics in the U.S. followed the collapse of the fixed exchange rate system. It picked up mildly under President Jimmy Carter. The Depository Institution Act of 1980 was his first distinctive, deregulatory policy. This act sought protection for financial institutions and depositors.[45] As indicated earlier, the election of President Reagan changed the deregulatory trajectory. But it was not until 1987 when the process increased in intensity and depth. That was when global stock markets suffered the worst crisis in six decades following the Great Depression. Notwithstanding regulatory recommendations of the Brady Report, the Reagan administration decided to allow financial markets to take their own course. The Brady Report was the outcome document produced by U.S. Presidential Taskforce on Market Mechanisms, which was instituted to investigate the cause of the crash and recommend solutions. The report outlined intrinsic problems of "market mechanisms" and pointed to the absence of a centralized regulatory "super agency" as the ultimate cause of market volatility.[46] Instead of enforcing the recommendations, the government rather strengthened the tacit "hands-off" policy at the

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[45] Paul R. Allen and William J. Wilhelm, "The Impact of the 1980 Depository Institutions Deregulation and Monetary Control Act on Market Value and Risk: Evidence from the Capital Markets," *Journal of Money, Credit, and Banking*, Vol. 20, No. 3 (August 1988, Part I); Khoury, *The Deregulation of the Financial Markets*, 80-86.

[46] Jerry W. Markham and Rita McCloy Stephanz, "The Stock Market Crash of 1987—The United States Looks at New Recommendations," *Georgetown Law Journal*, Vol. 76, No. 6 (1993), 1995; Bruce Greenwald and Jeremy Stein, "The Task Force Report: The Reasoning Behind the Recommendations," *The Journal of Economic Perspectives*, Vol.23, No. 3 (Summer 1988): 3-23; Anise C. Wallace, "The Brady Report: Looking for Flaws; Study Cites Portfolio Insurers' Role as a Key to Market Meltdown," *New York Times*, January 11, 1988.

international level.[47] The "hands-off" policy was reinforced by the collapse of the Soviet Union. The Soviet disintegration brought to the fore German unification and the desire of advanced capitalist states to spread capitalism to the communist spheres. The U.S led the transition of the collapsed communist realms into market-based system.[48]

The strategy of said transition began earlier when, in 1980s, the established liquidity standard or capital-asset ratio (net capital rule) which had been "the mainstay of financial responsibility program" of the SEC was amended for uniform net capital.[49] Established in 1975, the net capital rule required broker-dealer companies to maintain specified amounts in relation to their indebtedness. The rule amendment led to hyper internationalization of financial capital, fanned by accumulation and improvements in global telecommunications systems and networks. Non-banking institutions such as insurance companies and mutual funds joined the competition in making finance truly an international phenomenon.

As it turned out, the political foundation of regulatory coordination was unwilling to act when and where necessary to keep global finance synchronized with politics.[50] Managing finance in domestic or international context is like sailing in a rough weather or riding a panicky horse, Susan Strange argues. Such requires a firm pair of hands to direct the rudder post or the reins. In managing of international finance where the task is

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[47] See Ernst-Ludwig von Thadden, "Bank Capital Adequacy Regulation under the New Basel Accord," *Journal of Financial Intermediation*, Vol. 13 (2004), 90. See also Strange *Mad Money*, 8.

[48] Greenspan discusses his role a financial market sage and as a quasi-political participant in transitioning former Soviet satellite states into the market economy in his *The Age of Turbulence*, 136-139.

[49] Steven L. Molinari and Nelson S. Kibler, "Broker Dealers' Financial Responsibility under the Uniform Net Capital Rule—A Case for Liquidity," *Georgetown Law Journal*, Vol. 72, Issue 1 (October 1983), 1-2.

[50] For details on a classic lack of pragmatic regulatory coordination, see Hirsch, *Capital Offense: How Washington's Wise Men Turned America's Future to Wall Street*, 12-18.

more difficult not less, Strange advocates for multiple pairs of hands in handling it. The multiple pairs of hands that 'apparently' managed embedded liberal internationalism were lacking in the era of competitive liberalization and deregulation. Advanced capitalist collaborated in their parochial interest, and not for the interest of the system as a whole. As Greenspan ironically put it, they swapped "principle for power" and ended "up with neither." The lack of multiple guiding hands in the interest of the larger system marked the coming of the ugliest financial market meltdown in history.

6. THE COMING OF THE 2008 FINANCIAL CRISIS

The prime cause of the 2008 financial crisis was the lack of confidence in credit market processes and products. Until then, market confidence was a prevailing attitude in the U.S after the second shallowest recession in1990. Because that recession did not warrant political intervention, it increased market exuberance. Exuberance was already soaring because the rapid recovery from the 1987 stock market crash did not leave any visible outcome on GDP.[51] Such exuberance reinforced regulators' conviction in the capability and goodness of self-regulating markets, a conviction that was enhanced by the so-called sophisticated computer-based risk-management models that financial market institutions invented. As Greenspan revealed, confidence in the virtue of the self-regulating market led the Fed and many "a sophisticated investor to believe that future contractions would also prove no worse than a typical post-war recession."[52] Indeed, as Greenspan further pointed out, exuberance of the self-regulating market paradigm—a derivative of the

[51] Greenspan, "The Crisis Comments and Discussion," 211.

[52] Greenspan, "The Crisis Comments and Discussion," 211.

tension framework—was embraced by scholars, central bankers, and regulators to such an extent that by 2006, the hypothesis became the dominant global regulatory standard.

That stanch believe meant that the firm pair of handles needed on the reins of the nervous horse was discredited in favor of the horse's self moderating principles. Such was the case during the Great Moderation—the period of high output growth, relative decline in inflation, and less volatility in OECD economies.[53] Consequently, there was increasingly less need for "capital buffers." So dominant was the rational market consensus that the Fed and other regulating institutions failed to realize the size and magnitude of the crisis that lay ahead. That to say the belief in the efficient market hypothesis took away virility and vigor of pragmatic regulatory coordination.

The firm belief in the self-enforcing paradigm led to the passage of legislations, which inadvertently prepared the coming of the 2008 crisis. One such legislation was Graham-Leach-Bliley Act of 1999. This law successfully removed legislative barriers that Glass-Steagall Act of 1933and the Bank Holding Company Act of 1956 (amended in 1982) created.[54] The Glass-Steagall Act separated commercial banks from investment banks and put the former under the Fed's supervision while investment banks dealing in securities were supervised by the SEC. The Bank Holding Company Act, on the other

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[53] Domenico Giannone, Michael Lenza and Lucrezia Reichlin, "Explaining the Great Moderation: It is Not the Shocks," *Journal of European Economic Association*, Vol. 6, Issue 2/3 (April 2008), 1.

[54] James S. Ang and Terry Richardson, "The Underwriting Experience of Commercial Bank Affiliates Prior to Glass-Steagall Act: A Re-examination of Evidence for Passage of the Act," *Journal of Banking and Finance*, Vol. 18, Issue 2 (January 1994): 351-395; James A. Leach, "Introduction: Modernization of Financial Institutions," *The Journal of Corporation Law*, Vol. 25, No. 4 (Summer 2000): 681-690 (see p. 685 for arguments on competitiveness); Edward J. Janger and Paul M. Schwartz, "The Gramm-Leach-Bliley Act, Information Privacy, and the Limits of Default Rules," *Minnesota Law Review*, Vol. 86 (2001), 1219-1261 (see 1219 for quote). See also Aigbe Akhigbe and Ann Marie Whyte, "The Gramm-Leach-Bliley Act of 1999: Risk Implications for the Financial Services Industry," *The Journal of Financial Research*, Vol. 27, No. 3 (Fall 2004): 435-446.

hand, prevented banks from holding non-bank institutions, which means commercial banks could not own investment firms or any market institutions other than banks. In effect, the two federal statutes separated financial institutions into different categories.

The Graham-Leach-Bliley Act removed those firewalls and legal barriers and made possible all kinds of financial institutions—banks, bond markets, insurance firms, private financial regulatory institutions, real estate companies, consulting firms, mutual funds, and credit card companies—to crisscross one another on the global financial landscape. In effect, the act brought huge financial firms into being, with overlapping subsidiary holdings. Not only did those legislations enable mergers, consolidation, concentration, and centralization of power and influence of U.S. financial institutions, they enhanced international competitiveness of the country itself. Notably, they reflect a unified power identity, rather than a tension-filled competitive relationship. But as Paul Krugman argued in 1994, that kind of competitiveness was a "dangerous obsession."[55] He was right on target, considering the root causes of the 2008 global financial hurricane.

One of the immediate causes of the crisis was the amendment of the uniform net capital rule, which beginning in 1975, required broker-dealer companies to limit the ratio of their debt to equity to 12-to-1 and must issue early warning if they were approaching the limit.[56] The purpose of the rule was to prevent broker-dealer firms from holding large

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[55] Paul Krugman, "Competitiveness: A Dangerous Obsession," *Foreign Affairs*, Vol. 73, Issue 2 (March-April 1994): 28-44. On U.S. competitiveness, see Akhigbe and Whyte, "The Graham-Leach-Bliley Act of 1999," 436; Janger and Schwartz, "The Graham-Leach-Bliley Act, Information Privacy," 1223; Lissa L. Broome and Jerry W. Markham, "Banking and Insurance: Before and After Gramm-Leach-Bliley Act," *The Journal of Corporation Law*, Vol. 25 (1999-2000): 723-778.

[56] See also Julie Satow, "Ex-SEC Official Blames Agency for Blow-up of Broker Dealers," *The New York Sun*, September 2008.Robert S. Karmel, "Securities Regulation; News: The Blame Game," *New York Law Journal*, Vol. 240, Issue 75, October 16, 2008.

amounts in risky assets. Congress gave the SEC the sole administering responsibility, following a series of bankruptcies in the 1960s and 1970s. Before then New York Stock Exchange (NYSE) administered the rule. The Securities Investor Protection Act of 1970 stripped the NYSE of that right. In April 2004, the five largest investment banks (known as "lions") on Wall Street—Lehmann Brothers, Goldman Sachs, Bear Stearns, Merrill Lynch, and Morgan Stanley—persuaded the SEC to change the rule to allow their broker-dealer units to regulate themselves with their subjective, internally risk-based computer models, instead of the SEC regulating them with its command-and-control net capital rule. The rule amendments established "a group-wide supervision program" for the five brokerage units known as Consolidated Supervised Entities (CSE), each with at least $5 billion tentative net capital. In effect, the rule amendments exempted the brokerage units from the uniform net capital standard and allowed them to operate in the shadows of the economy, invisible to the public and 'perhaps,' imperceptible to regulators themselves.[57]

Essentially, the SEC replaced its statutory authority with CSE's voluntary self-regulating program, which structurally unleashed them for hazardous investments. It enabled them to transfer billions of dollars to their parent companies to undertake risky securitized mortgages and credit derivative swaps with exotic financial instruments. For instance, in March 2008 when Bear Stearns collapsed and was bought by J.P. Morgan

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[57] For details, see Stephen Labaton, "How SEC Opened Way for Storm in 55 Minutes 5 Major Investment Firms Persuaded Agency in 2004 to Exempt Them from Restriction," *International Herald Tribune*, October 4, 2008; "Obama's Speech on Overhauling Financial Regulation," *New York Times*, April 22, 2010; Harold Abramson, "The Fifth Branch of Government: The Private Regulators and Their Constitutionality," *Hasting Constitutional Law Quarterly*, Vol. 16, Issue 1 (Winter 1989): 165-220. Roger D. Congleton, "On the Political Economy of Financial Crisis and Bailout of 2008-2009," *Public Choice* (July 2009), 294; Christine Seib, "Don't Fight Us on Bank Reforms, Obama Tells Lions of Wall Street," *The Sunday Times*, April 23, 2010.

Chase in fire sale, its debt to net capital ratio was 33:1.[58] In essence, the net capital rule amendment was a follow-up on the Gramm-Leach-Bliley Act[59] in the sense that the latter did not put any regulatory mechanism in place after separating securities underwriting from commercial banking, making possible mergers of financial and non-financial institutions. The CSE program, on the other hand, facilitated excessive broker-dealer risk taking without any external supervision. Both the Gramm-Leach-Bliley Act and the CSE program reflect marketplace relations. They illustrate regulators and financial market participants acting collaboratively, rather than competitively.

The SEC commissioners justified the rule amendments on six grounds. The first was that market competitiveness at the global level had compelled the holding companies to develop the group-wide supervision program. That the companies consulted with the Federal Reserve and Department of the Treasury in developing the program. The second was that the imperatives of financial globalization made it necessary to link CSE's capital requirements closely to their "internal risk management procedures" instead of the firms relying on SEC requirements. The third was that CSE's computer models were first-rate alternatives for anticipating risk. The fourth reason was that self-regulation would enable broker-dealer to avoid overlapping and conflicting regulatory requirements in countries where they had stiff competition. That the SEC's equivalents in the European Union had threatened to regulate U.S. broker-dealer holding companies; hence, the rule change was

[58] Robin Sidel, Dennis K. Berman, and Kate Kelly, "J. P. Morgan Buys Bear in Fire Sale, as Fed Widens Credit to Avert Crisis," *The Wall Street Journal*, March 17, 2008. See also Stephen Labaton, "Agency's '04 Rule Let Banks Pile Up New Debt," *New York Times*, October 2, 2008; Karmel, "Securities Regulation; News: The Blame Game," 2.

[59] For details on the flexibility that said act brought to the financial industry, see Greenspan, *The Age of Turbulence*, 376; Khoury, *The Deregulation of the Financial Markets*, 62-64.

necessary to enhance international competitiveness of the broker-dealer firms and the country itself. The fifth justification was that market self-regulation was in the interest of the investing public because the investment firms would use the best available tools to manage risk. The last reason was that self-regulating credit institutions would continue to evolve and the health of the markets would improve.

Although some commissioners expressed doubts about compliance, inspection, as well as the complexity of risks that the group-wide self-supervision could generate, they approved the program. Its eventual outcome is now a significant element of the history of the 2008 global financial crisis. Christopher Cox, Chairman of the SEC at the time Lehman Brothers collapsed, admitted before Congress that the consolidated broker dealer self-regulating program was "fundamentally flawed from the beginning … [because] voluntary regulation does not work."[60] Indeed, self-regulation orthodoxy contravene the principles pragmatic regulatory coordination. But the contravention would not have occurred in the first place without politically enabling processes.

7. VIEWING THE MARKETPLACE FRAMEWORK VIA POLITICAL REACTIONS TO THE FINANCIAL CRISIS

At least two main reasons explain why the contemporary crisis helps us understand the marketplace framework. The first is the motivation of political authorities to resolve nagging uncertainties of the greatest financial market turmoil in history. The other has to do with the fact that the crisis itself was characterized by complex financial instruments,

[60] U.S. Securities and Exchange Commission, "Chairman Cox Announces End of Consolidated Supervised Entities Program," 09/26/2008, available from http://www.sec.gov/news/press/2008/2008-230.htm (accessed April 14, 2010). See also Stephen Labaton, "SEC Concedes Oversight Flaws Fueled Collapse," *New York Times*, September 27, 2008.

such as derivatives swaps, interest-rate swaps, and currency liquidity swaps and whose tentacles cut across sovereign realms. Managing these instruments elucidates the nature of regulatory coordination (both domestic and international) better than any other period in the history of finance. The international dimension of regulatory coordination could be seen in policy cooperation among states of varying interests and identities. The major coordinating institutions include the Federal Reserve, the Bank of England, European Central Bank, Swiss National Bank, and the Bank of Canada. The Federal Reserve, for instance, reduced short-term interest rates to near zero to stabilize the financial system and restart the flow of credit. In March 2008, the Fed was reported to have offered to allow the biggest Wall Street investment banks to borrow up to $200 billion in Treasury securities to help subdue the credit crisis.[61]

At domestic level (mindful of the inextricability of "domestic" and "foreign") for instance, the policy responses of the U.S. and U.K. (brazenly unregulated advanced liberal capitalist states) to their financial system meltdown and that of China (a centrally-controlled communist state) were not different in nature, purpose, and form. China's financial system was largely "unscathed" by the crisis, yet by November 2008, it injected

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[61] See "Statement by Ben S. Bernanke, Chairman, Board of Governors of the Federal Reserve System, Prepared for the Committee on Financial Services, U.S. House of Representatives," February 10, 2010, available from http://www.federalreserve.gov/newsevents/testimony/bernanke20100210a.pdf (accessed May 9, 2010). For details on collaborative efforts, see Jeannine Aversa, "Fed Takes New Steps to Ease Crisis," *Associated Press*, March 16, 2008; Edmund L. Andrews, "Fed Hopes to Ease Strain on Economic Activity," *New York Times*, March 12, 2008; Michael M. Grynbaum, "Fed Plans to Lend $200 billion to Banks," *New York Times*, March 11, 2008; Andrew Batson, "China Sets Big Stimulus Plan in Bid to Jump-Start Growth," *Wall Street Journal* (online version), November 10, 2008. Board of Governors of Federal Reserve System, "U.S. Dollar Liquidity Swaps, Supplementary FAQs," May 9, 2010, available from http://www.federalreserve.gov/newsevents/press/monetary/monetary20100510.pdf (accessed July 12, 2010).

about $586 billion to stimulate its economy to jump-start growth.[62] By December 2009, the British government paid £1 trillion to save its banking sector from collapse.[63] The bailout programs and *credit commitments* of the U.S. government to contain the impact of the crisis on its economy totaled $12.5 trillion by mid-September 2009. As of then, the actual amount the government spent out of the credit commitment was $2 trillion.[64] At any rate, the difference between China, Britain, and the U.S. in containing the crisis was only an issue of scale and scope; the purposes are the same, which explain how central finance is to politics and, for that matter, to the marketplace framework. Of course, financial policy coordination among states is not anew phenomenon, as the previous chapter shows. Finance is central to IPE. Hence, it was not surprising for governments to coordinate policies to curb the crisis from tipping the world economy into a recession.

The point being made here is that the cause of financial crisis (as the previous section demonstrates) is not the result of "tension" that supposedly exists between markets and states; it is rather lax in application of the principles of the marketplace framework. It is the case of political actors allowing financial market institutions to outgrow governments. It is a deliberate decision of resourceful states using "markets" as

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[62] See Batson, "China Sets Big Stimulus Plan in Bid to Jump-Start Growth;" Geoff Dyer and Andrew Wood, "Global Markets Sheered by Huge China Financial Stimulus Package," *Financial Times*, November 11, 2008.

[63] Landon Thomas, Jr., "Britain to Levy a One-Time Tax on Banker Bonuses," *New York Times*, December 9, 2009.

[64] The commitments include guarantees on bank debts ($789 billion) and deposit accounts ($736 billion), loans to financial firms ($1.34 trillion), Term Asset-Backed Securities Loan Facility ($1.0 trillion), public-private investment program ($1.0 trillion), debt and mortgage-backed securities purchase program ($1.45 trillion), support for money markets mutual funds ($3.0 trillion), and funding for commercial paper ($1.8 trillion). It is important to note that the actual spending figures differ from projected commitments. What matters to us, however, is the commitment. For details on these figures, see Amy Schoenfeld and Dylan Loeb McClain, "The Bailouts: An Accounting," *New York Times*, September 14, 2009.

a tool to penetrate independence experimenting states under the pretext of state-market tension. The adoption of the hegemonic doctrine of market efficiency over effective regulatory coordination was a political decision that undermined public confidence and systemic guarantees. Such a decision enabled banks to over leverage while credit rating agencies failed in their function to ascertain and expose investment related risks, fraud, and abuse.

The marketplace principle was evident in a testimony to Congress by Henry Paulson, Jr., the U.S. Treasury Secretary during the financial system bailout. He admitted the necessity for the U.S. government to intervene in the market:

> people were unhappy with the big discrepancies in wealth, but they at least believed in the system and in some form of market-driven capitalism. But if we [the nation] had a complete meltdown, it could lead to people questioning the basis of the system **….** I looked at how, when a financial system fails, a whole country's economic system can fail.[65]

This quotation shows why it was absolutely necessary for the government to prevent the financial system from collapse. The need stemmed from the fact that finance is at the heart of the advanced liberal capitalist economy, which in turn, is at the heart of the global political economy. The U.S. government's direct intervention took varied forms. One was the Troubled Asset Relief Program (TARP), which involved purchasing from credit institutions "undigested" financial assets and equities in order to inject confidence and trust into the U.S. economy (and the global economy, by extension). Specifically, Paulson's statement highlights the responsibility of advanced liberal capitalist states to

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[65] Secretary Paulson was on Capitol Hill to defend the Bush Administration's response to the financial system bailout and his personal role in Bank of America's $50 billion acquisition of Merrill Lynch. For details, see Michael Cokery, "Paulson's Version of Financial Armageddon: 'People in the Streets,'" *The Wall Street Journal*, July 16, 2009.

their financial market institutions. His statement is an affirmation of the first-order-relationship between finance and the advanced capitalist state. The marketplace relation is again understood via Goldman Sachs' decision in 2009 to eliminate cash bonuses for top executive—an attempt to quell public anger over the firm's executive compensation.[66]

The 2009 proposal by the British Government to levy a one-time fifty percent tax on bankers' bonuses also reveals a marketplace relation. The suggestion was described as an "unthinkable" direct attack on bank bonuses anywhere in the world. But as Alistair Darling, then Chancellor of the Exchequer pointed out, the government's action was "mostly a political symbol"[67] because (as Darling explained to bankers), the levy would raise "only £550 million—an amount that would hardly make up for a yawning budget deficit, let alone the roughly £1 trillion" extended to shore up the banks.[68] Doing so would have been a political compensation for regulatory coordination failures. At any rate, the notion of a *political symbol* was a subtle acknowledgement that a tensile relationship does not exist after all, but for promoting such myth, the political structure had to make a gesture of accountability.

8. DURING AND AFTER THE CRISIS: UNDERSTANDING MARKETPLACE FRAMEWORK THROUGH ACTORS

The marketplace framework is very clear from the close relationships between political authorities and financial market participants themselves. The case of Neel T. Kashkari,

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[66] Justin Baer, "Goldman Scraps Cash Bonuses for Leaders," *Financial Times*, December 10, 2009; Jenny Anderson, "Goldman Sachs Alters Its Bonus Policy to Quell Uproar," *The New York Times*, December 10, 2009.

[67] Landon Thomas, Jr., "Britain to Levy a One-Time Tax on Banker Bonuses," *New York Times*, December 9, 2009.

[68] See Thomas, Jr., "Britain to Levy a One-Time Tax on Banker Bonuses."

"the $700 billion man,"[69] is of importance. Kashkari was appointed by Henry Paulson as Interim Assistant Treasury Secretary in-charge of the Office of Financial Stability, an office created by the Emergency Economic Stabilization Act of 2008 to buy "troubled assets" from market institutions. Before his appointment, Kashkari was a Treasury Department senior adviser. He served as Assistant Secretary for International Economics and Development. Like Paulson, he was a former executive officer at Goldman Sachs, where he headed Information Technology Security Investment division in San Francisco. Kashkari resigned his post on May 1, 2009. Eight months later, he was appointed Managing Director and Head of New Investment Initiatives at the Pacific Investment Management Company (PIMCO), headquartered in Newport Beach, California.[70]

As of December 2009, PIMCO was reported as the world's largest and most successful bond investment company, with more than $940 billion in assets.[71] Its top executives continuously boasted of access to key (former) federal government officials. One such official was Alan Greenspan, the former chairman of the Fed. PIMCO hired

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[69] Laura Blumenfeld, "The $700 Billion Man," *The Washington Post,* December 6, 2009.

[70] See "Neel Kashkari Discusses PIMCO's Equity Platform and First Active Equity Strategy," April 10, 2010, available from http://media.pimco-global.com/pdfs/pdf/Spotlight%20Kashkari_Global_FINAL.pdf?WT.cg_n=PIMCO-US&WT.ti=Spotlight%20Kashkari_Global_FINAL.pdf (accessed July 17, 2010).

[71] Kristina Cooke, "Pimco's Gross Says Not Government Player," *Reuters*, December 9, 2009, available from http://www.reuters.com/article/idUSTRE5B859V20091209?loomia_ow=t0:s0:a49:g43:r1:c1.000000:b30346660:z0 (accessed September 18, 2010); Min Zeng, "Pimco's Total Return Fund Soared in 2009," *The Wall Street Journal*, January 20, 2010; Sree Vidya Bhaktavatsalam, "Greenspan Helped Pimco Make Billions, Gross Says," *Bloomberg*, May 21, 2008, available from http://www.bloomberg.com/apps/news?pid=newsarchive&sid=a1c7Ck736daM (accessed July 17, 2010).

him as a consultant, five months after he retired from office. Seven months thereafter, he was hired by a New York-based global hedge fund, Paulson & Co. Inc., as an adviser.[72]

In fact, this kind of strong ties between former government appointees and financial market institutions made critics' accusation that Kashkari was doing PIMCO's bidding while a Washington political insider, credible. The credibility stems from the fact that during Kashkari's tenure as TARP administrator, PIMCO's founder and co-chief investment officer (William Gross), was reported to have "frequently offered advice to the Treasury about how to handle the bailout program." Of course, Kashkari was the chief bailout officer. Besides the "advice," Gross boasted of PIMCO's strategy to invest in "areas that would benefit from the government's rescue efforts."[73] PIMCO called the strategy its "shake hands with the government."[74] Certainly, it was a "shake hands" plan, in view of how Greenspan (in his role as a consultant) had helped the company to make billions of dollars.[75] Moreover, PIMCO was an asset manager for the Federal Reserve's Commercial Paper Funding Facility, and until the summer of 2009, one of four managers of the Fed's "$1.25 trillion mortgage-backed securities purchase program."[76]

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[72] Angela Monaghan, "Greenspan Joins Hedge Fund Paulson," London, *Daily Telegraph*, January 15, 2008. Devin Leonard, "After a Year of Tumult at Treasury, Former Bailout Chief Took a Quiet Path to Pimco," *New York Times*, January1, 2010; Devin Leonard, "Neel Kashkari's Quiet Path to Pimco," *New York Times*, December 31, 2009; Charlie Savage, "Bailout Role Elevates U.S. Official," *New York Times*, October 8, 2008; "Pimco Hires Greenspan as Consultant: Report," *Reuters*, May 16, 2007, available from http://www.reuters.com/article/idUSN1546703720070516 (accessed July 17, 2010).

[73] Leonard, "After a Year of Tumult at Treasury, Former Bailout Chief Took a Quiet Path to Pimco."

[74] Leonard, "After a Year of Tumult at Treasury, Former Bailout Chief Took a Quiet Path."

[75] Bhaktavatsalam, "Greenspan Helped Pimco Make Billions, Gross Says."

[76] See Cooke, "Pimco's Gross Says Not Government Player."

At issue is the relationships between political authorities and financial market players—relations in terms of the mutual exchange of inside knowledge and enriching personal connections. Kashkari had political experience from government, knowledge of the workings of the financial industry, and exceptional understanding of how both sectors interact in the marketplace of trust. As the "shake hands with government" plan suggests, some of the ideas U.S. government officials implemented during the crisis came from financial market institutions. Those financial institutions ended up investing in the very "event-driven strategies" and programs they advised Treasury officials to pursue.

In this instance, the least said about Greenspan the better. His handling of the U.S. economy for eighteen years as Fed chairman vis-à-vis his retirement consultation roles to private investment funds that made "billions of dollars" speculating (based on his "brilliance in terms of forecasting the potential for exactly what happened")[77] in bonds, is a clear case of the marketplace relations. This is in view of the fact that in June 2003 Greenspan cut the benchmark interest rate to 1 percent, the lowest since 1958, and maintained it so low for far too long. The central bank interest rate, as noted earlier, is the key stabilizing instrument in the capitalist economy. Thus, Greenspan's unrivalled insider knowledge and actual record of interest rate management as Fed Chairman vis-à-vis his retirement consulting role of forecasting economic and financial outcomes for private investment advisory companies, is not conflictual or tension-packed; it is a marketplace phenomenon. Such is the finest relationship between finance and politics.

[77] Bhaktavatsalam, "Greenspan Helped Pimco Make Billions, Gross Says."

Another instance of relations between political authorities and financial market participants could be seen in the career of Henry Paulson himself. He was the Chairman of Goldman Sachs at the time the SEC approved the net capital rule amendment. His appointment two years later as Treasury Secretary illustrates the deep connections in the marketplace relations of politics and finance.

Of course, Paulson was not alone in this circumstance; well known appointments of this kind were made and continue to be made. President Bill Clinton appointed Robert E. Rubin Treasury Secretary (1995-1999) after he (Rubin) spent 26 years at Goldman Sachs, partly as a Board member and as Co-Chairman.[78] His major post-government position was Director and Senior Counselor to Citigroup, one of the important financial institutions and a key beneficiary of the TARP program. The number and consistency of former political appointees, regulators, Federal Reserve governors as well as lawmakers of high-paying positions on Wall Street or serving as lobbyists on behalf of financial institutions are pervasively familiar rather than exceptional. As Michael Hirsh noted in reference to Greenspan and Rubin, both are "fundamentally Men of Wall Street. Wall Street was their spawning ground. Wall Street had given them their fortunes and their world views. It had shaped them. It grounded them."[79]

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[78] Robert E. Rubin and Jacob Weisberg, *In An Uncertain World: Though Choices from Wall Street to Washington* (New York: Random House, 2004), x; Francesco Guerrera and Alan Rappeport, "Rubin and Greenspan Face Crisis Inquiry," *Financial Times*, April 4, 2010; James Politi, Francesco Guerrera and Alan Rappeport, "Former Citi Chiefs Say Sorry for Losses," *Financial Times*, April 9, 2010; Robert Reich, "Time to Take Wall Street out of Washington," *Financial Times*, April 26, 2010.

[79] For reference to a former governor of the Federal Reserve selling his inside knowledge to an investment bank, see Lewis, "For the Love of Money: Why Central Banks and Speculators Need Each Other," 141. See Hirsh, *Capital Offense*, 3.

In these instances, nothing is indicative of the presence of tension in the relations between political authorities and financial market entrepreneurs. The open boasting of PIMCO's top executives of access to government officials is a clear example of the lack of tension. Greenspan, Rubin, Paulson, and Kashkari's relations as regulators and market players were not viewed as the actions of traitors to their side, but rather as examples of the height to which they had achieved in their career. And such is a mark of the marketplace framework, not tension phenomenon.

9. MARKETPLACE FRAMEWORK VIA FINANCIAL INSTRUMENTS

Crisis management and embedded relationships between regulators and financial market players aside, the marketplace framework is evident via the credit instruments that bind states and markets. Interest-rate swap, for instance, helps governments to manage swings in their lending and borrowing costs. They do so by exchanging floating-rate payments for fixed-rates-ones, or vice versa. In other words, currency swap can help reduce the impact of unstable foreign exchange rates. For instance, J. P. Morgan investment firm and Italian government entered that kind of exchange arrangement, which enabled Italy to bring its budget into shape at a favorable exchange rate. The deal effectively put more financial resources into the government's coffers. The government agreed to future payments that were not recorded as liabilities.[80]

That derivative transaction was one of the risky activities resulting from the decision to liberalize and integrate financial markets in the City of London and on Wall

[80] Louise Story, Landon Thomas, Jr., and Nelson D. Schwartz, "Wall St. Helped Greece to Mask Debt Fueling Europe's Crisis," *New York Times*, February 14, 2010.

Street. The creation and trading of risk-laden credit instruments would not be possible without the blessings of both governments of the two advanced liberal capitalist states. Globalization in the broader sense would not have been possible without financial liberalization. Ultimately, as Susan Strange explained, the banks in each country "paid" the national financial authorities for their sheltered market in terms of *how much credit they could create, in what form and for whose benefit*."[81] This observation reinforces Huntington's explanation of U.S. and transnationalism and Windmiller (see chapter 2) views about the relationship between U.S. government and businesses. According to Windmiller the U.S. government ensures market expansion while markets serve the expansion of political power. That is the symbiotic marketplace relation.

In fact, debt securitization, interest-rate swaps, and currency liquidity swaps between financial market institutions of one country and governments other than their own shows that tension does not exist as a core element shaping their relations. Not only do those transactions help governments to balance their budgets in the short-run (in spite of the long term effects), they also help financial market institutions make huge windfall profits. Such was the case with periphery states in the European Union, including Italy and Greece, which reported derivative swaps as "sales" on their balance sheets instead of classifying them as "loans." Not only did political actors enter those transactions in spite of mounting criticisms, they did so knowing full well the long-term implications of defaults, including payment obligations and eventual saddling of their state.[82]

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[81] Strange, "Finance, Information and Power," 265.

[82] On short- and long-term international impact of derivative swaps, see Nelson D. Schwartz and Eric Dash, "Greek Debt Woes Ripple Outward, From Asia to U.S.," *New York Times*, May 8, 2010; Story et el., "Wall St. Helped Greece Debt Fueling Europe's Crisis."

10. CONCLUSION

This chapter has attempted to explain the marketplace framework in its contemporary setting. This setting refers to two separate, but interrelated periods: embedded liberal internationalism (1944-1971) and re-globalization of finance from 1970s up until the 2008 global financial crisis. The chapter examines specific statutes, international financial policy choices, global economic events, and internal as well as international political processes that shaped relations between states and financial market institutions. Those policies and political processes were either for effective control or deregulation of financial markets of advanced capitalist states. The chapter focuses on American and British market economies—economies that are distinctively underpinned by international credit organization, pointing out the double movement processes entailed in their credit market policies. They include postwar hegemonic guarantees provided by the U.S. (with support from Britain), implicit and explicit financial policies to contain the Soviet Union, establishment of the Eurodollar markets for U.S. financial leadership in Western Europe, the 1960s bank expansion in the U.S., deficit financing by the hegemon, the Triffin Dilemma and the collapse of the fixed exchange regime. The chapter argues that both embedded liberal internationalism and neoliberalization projects could not have taken place without actions and inactions of the two advanced liberal capitalist states.[83]

Attention is also focused on relations between the financial centers of the U.K. and U.S. and their respective governments, the goals and impacts of monetary policies of both countries, and the creation of credit instruments such as "Negotiable Certificate of

[83] This argument adds to the growing literature on the subject of advanced capitalist economies' involvement in capital control within the Bretton Woods monetary system as well as in re-globalization of financial markets.

Deposit" in the U.S. Emphasis is given to deregulatory policies, their impact and implications in the U.K. More importantly, attention is focused on the "hands off" policy of advanced countries to interventionism, the passage of Financial Services Act of 1985 in the U.K., which allowed transformation of informal regulatory agencies into a private Securities and Investment Board. The deregulatory policies and statutes in the U.S. include Depository Institution Act of 1980, the Graham-Leach-Bliley Act of 1999. The processes and impacts of the SEC net capital rule amendment, intra-relationships between regulators and financial market actors and coordinated management of the 2008 crisis are examined.

The chapter concludes that the marketplace relation is a pragmatic balancing act between politics and finance, in that social and political forces determine its direction. It is that sense that the same powers that restricted financial markets during embedded liberal internationalism were the same institutions that enabled networks of contemporary financial globalization. Financial market institutions exploited regulatory coordination because state actors allowed them. President Nixon's unilateral decision to liberalize finance in the early 1970s and the subsequent deregulation of NYSE in May 1975 are few examples of powerful states' blessing for the current financial system. States promote liberalization while making new regulations to "guarantee property rights, contracts and currencies."[84] John Eatwell and Lance Taylor put this view succinctly, when they argued

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[84] Cerny, "The Deregulation and Re-regulation of Financial Markets in a More Open World," 51-85. Khoury makes similar argument when he noted that "market observers have argued that the deregulation of financial markets is a 'mirage.' Indeed, they suggest that a careful examination of the laws passed during the 1980s would show that these acts were as much attempts to regulate the market as they were attempts to deregulate the market." See Khoury, *The Deregulation of the Financial Markets*, 100.

that "liberal markets are only efficient when they are efficiently regulated."[85] Indeed, that is the essence of the marketplace framework, which is predicated on the recognition that regulation/deregulation and competition are complementary.[86] The pragmatic nature of the marketplace framework is vindicate by Greenspan's call for regulation of finance.

[85] John Eatwell and Lance Taylor, “Introduction,” *International Capital Markets*, 4.

[86] Timothy J. Brennan, “Regulation and Competition as Complements,” in *Obtaining the Best from Regulation Competition*, Michael A Crew and Menahem Spiegel, ed. (New York: Kluwer Academic Publishers, 2005): 1-20.

CHAPTER 7: CONCLUSION

THE MARKETPLACE FRAMEWORK AND THE STUDY OF INTERNATIONAL POLITICAL ECONOMY

> But what is government itself but the greatest of all reflections on human nature? If men were angels, no government would be necessary. If angels were to govern men, neither external nor internal controls on government would be necessary. In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed, and in the next place oblige it to govern itself.
>
> –James Madison[1]

> Many political writers … have declared that the business of government is simply to afford protection, to repel, or to punish, internal or external violence or fraud, and that to do more is usurpation. This proposition I cannot admit. The only rational foundation of government … is *expediency*—the general benefit of a community. It is the *duty* of the government to do *whatever is conducive* to the welfare of the governed.
>
> –M. Bowley[2]

> This is an aspect of the problem that economists tend to overlook. They tend to take politics for granted. But, as in sailing in rough weather or riding a nervous horse, when the task becomes more difficult, common sense and experience tell us that there is more, not less, need for a firm pair of hands on the tiller or the reins. The basic problem, however, is that in managing international finance there is not one pair of hands in charge but many – many governments, many international organizations, many national authorities.
>
> –Susan Strange[3]

1. INTRODUCTION

These statements reflect the intent of this closing chapter, which is about the nature of political economy via relationships of states and markets. The conceptual framework that has shaped the study of this relationship from early 1980s has been the tension paradigm.

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[1] James Madison, "Federalist No. 51," in *The Federalist Papers*, edited with Introduction by Clinton Rossiter (New York: The New American Library, 1788/1961), 322.

[2] Quoted in Parris, "The Nineteenth-Century Revolution in Government: A Reappraisal Reappraised," 36 (emphasis is mine).

[3] Strange, *Mad Money: When Markets Outgrow Governments*, 43.

The core of this paradigm is the rational market theory, which in essence, is about free, competitive, self-regulating market economy purportedly girded by perfect information and price adjusting mechanism. Mainstream IPE scholarship theorized this relationship into two opposing governing spheres, with the "state" embodying the logics of politics while the "market" represents the logics of economics. These two governing institutions are conceived as having independent existences and logics of their own, but inseparably interact in a tensile, combative manner. Their relationship in the world arena has been constituted, analyzed and interpreted as an epic struggle for wealth and power. This antipodean relationship means markets have natural proclivity to grow beyond political space in allocating resources while state actors relentlessly seek to control markets within their politically defined domains. This *inevitable tension* between national governments and (trans)nationalized markets is what I mean by "tension framework."

Thus, guided by their internal logics and mechanisms, market forces negotiate political processes and decisions while state actors manage their responsibilities with considerable regard for the logics of markets. Depending on prevailing social conditions and context, the logic of politics may override the logic of markets, or market forces may prevail over "political definition of outcome." In this sense, mainstream IPE research and teaching frame states as being on the defense and markets as winning the epic struggle in our increasingly integrating world economy. In other words, states have generally been written about as being acted upon (or constrained to be acted upon) by global market forces. Although conceived this way, it is reasoned, the relationship has never been stable for long; the pendulum oscillates in opposite directions for reasons that are tensile in nature. In this sense, the theoretical direction and practical manifestations of the global economy are results of the tensile, interactive processes between the two governing institutions.

This conception of states and markets as dual rudders has been the established mode of perceiving, analyzing, and interpreting IPE as a discipline and as a set of global practices and conditions. Such has been the dominant intellectual perspective imparted to students of IPE and accepted by politicians, market participants, and the public at large. Not only has this mode of thought been the guiding framework for national and, indeed, international policy choices and processes, it was generally believed to be the best functioning structure of our globalizing world economy. It was zeitgeist of liberalization of national economies, privatization of public services and competitive deregulation of restrictive rules to enable greater private sector participation in the global economy.

2. THEME OF DISSERTATION

The dissertation takes issue with this conceptual framework and its central hypothesis, on two grounds. First, it argues that the underlying assumptions of the tension framework are not only fuzzy and inadequate in explaining relationships between states and markets at specific units of conception, but they conceal the nature of IPE. Second, the reality of the 2008 global financial crisis and the political reactions to the crisis itself, including national credit system rescue, massive debt guarantees, outright purchases of indigestible bank assets, liquidity injection into domestic and global market institutions at near zero interest rates, and national economic stimulus packages of wide-ranging sizes, exposed the weakness of the tension framework and its fundamental suppositions. Not only did the self-stabilizing, market-clearing equilibrium mechanism fail to regulate demand and supply of products and services (as market theorist claim), but the efficient and rational market hypothesis left the global economy disarrayed, a situation that required pragmatic regulatory policy coordination from advanced and emerging market economies to restore some trust and confidence into the global political economy. The *need* for and the actual interventions, coupled with Alan Greenspan's admission of the "flaws" of the rational market hypothesis, undermined the tension framework. The failure of this framework left a conceptual gap between orthodox IPE and the reality of the crisis. It is in this context that I argue that the "marketplace framework" is a better alternative for studying IPE. In effect, the marketplace framework is a critique of the tension paradigm.

3. DECONSTRCTING THE TENSION FRAMEWORK

The dissertation deconstructs the tension framework, highlighting its contradictions as derivatives of rationalist realist IR theory, which broadly analyzes interstate relations through the prisms of national power, conflict, and war. The deconstruction emphasizes two interrelated processes. First it analyzes how powerful states owe their very existence to tension-laden themes, including conquest, subjugation, territorial expansion, control, force and competition. Second, it shows how these tension-clusters were regurgitated and appropriated from hierarchically organized, security-oriented, Janus-like state-society organization into horizontally ordered, state-market relations for globalizing entities.

In doing so, the dissertation outlines prevailing conditions that facilitated the appropriation process. Such includes scholarly debates on the changing post-World War II political economy of international relations. The debates were broadly framed and contested along such approaches as "interdependence," "transnationalism," "hegemonic stability theory," "embedded liberalism" and "liberal institutionalism." The study focused on advanced liberal capitalist states, highlighting their political cultures, ideological orientation and material conditions as fundamental signposts in the appropriation process. The dissertation attributes the dominance of the tension paradigm to the "power paradox" of illusory reality of tension between states and markets, which enabled a shift from state-centered architecture of governance to pro-market structures of governance.

4. THE MARKETPLACE FRAMEWORK

The marketplace framework is structured on the premise that the tension framework categorizes states and markets as if they are homogenous institutions in their respective domains. Markets, however, differ and overlap, notwithstanding the price mechanism that arguably defines them, and each relates with states, which also differ and overlap, in fundamentally different ways. For instance, there are primary commodity markets and labor markets of different kinds. Financial markets, with their complex subtypes are unique among markets because of their object of pursuit: credit organization. Credit organization—based on price adjusting mechanism—is their peculiar excellence. Thus, financial markets should be conceptualized differently and studied as such. Their unique character stems from the fact that the efficiency of the price system is proportioned by the extent of pragmatic regulatory coordination between finance and politics. It is pragmatic regulatory coordination that guarantees the price mechanism.

Like markets, states differ and overlap in their social structures, political cultures, competence creating capabilities, natural endowment, and efficacy of their administrative means. States differ in their manifestations of power, authority, influence and capacity to induce compliance. The notion of the "state" is burdened with "incomplete construction" of identities. And as a result, there are all kinds of states. There are neocolonialist states, emerging market states, developing states of various kinds, predatory states, monarchical states, communist states, socialist states, (neo)liberal states, and "virtual" or "globalized" states of varying competence producing capabilities. Hyper-liberal capitalist states differ from other states because of the peculiar nature of their financial structures.

The distinctiveness of advanced liberal states stems from the fact that: 1) they are organizationally strong (by virtue of the *power paradox*) and their institutional structures are organized more efficiently than other states; 2) they are politically more globalizing and financially transnationalized than other states; 3) their form and degree of governance embody consensus and legitimacy, and allow a greater degree of liberty for their citizens and private economic institutions with clear-cut separation between control, ownership, and management; 4) their credit markets (with longer history of financial dominance) are more open and "deep," more "liquid" and "globalizing," and are led by financial market institutions rather than by the state; 5) they do not only have uninterrupted access to internal and foreign sources of credit, they have the capacity to issue "debt in their own currencies" under their own laws. In effect, they embody the "soft power" of attraction.

Notably, the relationship of the two liberal states, U.S. and U.K, is reciprocal, with similar political cultures and common legal and economic heritage. Both have been more successful in fusing political processes and "freewheeling capitalism" than others. In effect, the freedom of individuals and institutions are protected by the rule of law without "visible" government presence. They are characteristically mature markets in a state of equilibrium before the 2008 financial crisis. And being the most unrestraint world financial centers, both were the epicenters of the most virulent global credit crisis.

In other words, relations between advanced liberal capitalist states and finance—the liberal state's distinctive *means* of administration (Weber)—differ from all other types of states. Finance is the foundation of the politics these states, which means that political derivativeness of finance and financial derivativeness of politics are a reflection of the nature of the advanced liberal capitalist states. Credit organization—their distinguishing trait—is shaped by what I call "pragmatic regulatory coordination." Pragmatic regulatory coordination ensures effectiveness of the price mechanism, which is fundamental to the working of the advanced liberal capitalist economy and by extension, the global market economy. Pragmatic coordination is imperative because finance is the tectonic structure upon which the social and political compacts of the capitalist system are constituted.

5. PRAGMATIC REGULATORY COORDINATION

Pragmatic regulatory coordination is the "power paradox" embedded in the liberal capitalist system. It consists of broad statutory instruments and extraordinary political processes that are formal and informal, official and unofficial, specific and vague, open and concealed, expedient and subtly sinuous. It takes the form of vital political/economic institutions being *insulated* from politics, and whose policies, though critical for the well functioning of the liberal capitalist system and the broader interstate system, are depicted as if they are *independent* of political processes. That is to say the policy choices of those *insulated* institutions are perceived, interpreted, and consumed as if they are truly in tension with advanced capitalist states. Such institutions are the "cunning wily foxes" fortifying the tension framework. They are the vital elements of the power and authority as well as the fountain of confidence and trust in the liberal capitalist system.

Pragmatic regulatory coordination not only makes the global political economy go round, it makes the world system appear as what it is: tension with itself. But tension cannot exist in a system without corresponding coordination somewhere. Pragmatic regulatory coordination keeps the tension dynamics encompassing. It is the postulated sustaining and uniting principle of the advanced liberal capitalist economy, which by its nature is the axis of the circumferential global political economy. Because the circuitous, convertible and channeling logic of finance is disharmonic to liberal capitalism, effective regulatory coordination enables competitive equilibrium in the sense that it improves allocative and distributive efficiency of capital. Ineffective (or lack of commitment to) regulatory coordinating principles degenerates the political economy into volatility and crises. Such undermine confidence and trust, which are essential for credit organization.

In essence, the marketplace framework is about understanding IPE through the relationship of advanced liberal capitalist states and their financial markets. These units of analysis are different component parts of the international political economy. As such understanding their relationships is a prerequisite for perceiving the coherent whole of IPE as well as its governing philosophy. That philosophy *divorces*, *isolates*, or *designates* the economy—physical and finance—as self-regulating realm detached from the statist politics. In this sense, the dissertation places emphasis on the role of the liberal legal system in designating the economy as such. Designation is possible because: 1.) finance is a "legal fiction" structured in percentages of shares, debts, equities, etc; 2.) the "power paradox," or pragmatic regulatory coordination, is a self-enforcing mechanism.

6. METHODOLOGICAL APPROACH

The dissertation examines the marketplace framework in historical and contemporary contexts by examining the evolution, development, consolidation, and expansion of financial capitalism in the two advanced liberal capitalist states. It emphasizes the role of finance as the "bellows" that fanned the development of western form of capitalism in general and consolidation of the two states. It focuses on social, political, and economic processes/events that reflect marketplace relations in both states. It delineates regulatory coordination processes and actions from domestic policies (e.g., the creation and trading of government bonds, establishment of central banks, development of stable and uniform currencies, monetary and fiscal policies, the nurturing of monopoly institutions such as stock exchanges, macroeconomic policies, corporate sector plans, etc) and foreign policy strategies, including foreign investment relations, and defense related spending (broadly defined). Such includes statutorily regulatory measures and systemic private-financial practices as well as confidence and trust generating statements and policies by prominent statesmen and financial market players.

Also examined are interactions between major political authorities and financial market players in managing populist tension in relation to the development and growth of national financial structures. The focus is on how such policies and processes unified as well as shaped the expansion of financial capitalism, bearing in mind interconnectedness of foreign and domestic spheres. Instances of ineffective regulatory coordination across political space are discussed. The marketplace framework as reflected via transnational financial crises and reactions, including the stock market crash of 1929 and the Great Depression are assessed. Lastly, the politics and polices that shaped embedded liberalism internationalism and re-globalization of finance are explored.

In sum, empirical evidence of the marketplace framework is divided into two sections. The first part focuses on the historical processes, touching on the beginning of financial governance in both states up until World War II. The second part examines the contemporary period, which covers post-World War II period up to the 2008 crisis. In that sense, the marketplace framework reflects regulatory, deregulatory, self-regulatory and all of the coordinating processes that shaped global financial governance.

7. RELEVANCE OF THE MARKETPLACE FRAMEWORK

The marketplace framework is an alternative conceptual frame for analyzing nature of IPE. It is developed in the context of the 2008 financial crisis and the coordinated policy interventions that subdued the crisis itself. Those interventions have created what Susan Strange refers to as "Pinocchio's problem,"[4] in the sense that once Pinocchio became a real boy, he no longer had his puppet strings to guide him, therefore, no "power paradox" to coordinate his behavior. In other words, the massive financial market bailout (still ongoing in some form) have not only left IPE students in confusion, they have exposed the façade of the tension framework—the premise on which social and political lives of the neoliberal world have been structured. Revelations of embeddings of state-market relations is curtain torn. The effects include the growing public skepticism, resentments, institutional dissatisfaction, cynicism, "greater political activism" and anti-financial market rhetoric and what Kimberley Strassel calls "bonfire of the populists."[5] In other words, public trust and confidence in financial markets have declined and at low ebb.

These are worrying signs (in form and substance) in capitalist democratic political institutions. In years to come, greater state intervention, coordination, and supervision will be expected, without them political loyalty will be undermined. A clear case in point

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[4] Strange, *Retreat of the State*, 198-199.

[5] Kimberley A. Strassel, "Bonfire of the Populists," *The Wall Street Journal*, January 28, 2010. On public confidence, see "Reassurance in the Old Lady's Ritual," *Financial Times*, August 11, 2010; "Fed Chief's Testimony Hits Market Confidence," *Financial Times*, July 21, 2010. See also Confederation of British Industry, "The Shape of Business: The Next 10 Years," November 2009, p. 4, available from http://www.cbi.org.uk/pdf/20091123-cbi-shape-of-business.pdf (accessed November 23, 2009).

was bankers of Goldman Sachs buying firearms to defend themselves in case of populist attack against the bank, which is the reality of ordinary citizens coming to terms with the tension framework as nothing but a "financial industry-led plutocracy."[6] Indeed, it is not only populist agitation; some players within the financial industry are aggrieved for the fact that other players and their institutions have had closer relations with political actors.

In the face of this indictments, the marketplace framework is the best conceptual tool for rebuilding confidence in mature capitalist states and in the global economy. It holds the key for effective governance in our globalizing world economy because it has the potential to help nurture a different mindset about how we conceptualize the global political economy. It will help citizens and electorates understand the relations between states and financial markets as an "exchange" rather than a tension phenomenon. In that sense, the marketplace framework will allow for harmonization of financial, economic, social, and political ends within and beyond the so-called sovereign space. Broadly speaking, citizens will understand that states do intervene in financial markets not only in times of crisis, but as a continuing process that makes the political economy functional. They will understand the essential coordinating principles and conditions of the marketplace framework as a confidence and trust exchange system, the postulated sustaining principle of the global economy.

Specifically, the marketplace framework will enable our understanding of government and markets not as problems in themselves, but their relationship is what we make of them. Governments have their failures just like markets. As James Madison rightly put it (see epigram above), government is nothing more or less than "the greatest

[6] Alice Schroeder, "Arming Goldman with Pistols against Public: Alice Schroeder," *Bloomberg*, November 30, 2009, available http://www.bloomberg.com/apps/news?pid=20670001&sid=ahD2WoDAL9h0 (accessed Dec. 8, 2009).

of all reflections on human nature." To paraphrase him, the greatest difficulty in framing a government lies in the fact that the governed must first enable the government to engage in pragmatic regulatory coordination of financial structures, which in turn, will guarantee socially embedded allocation of resources. That the business of the state is not only to provide physical protection, discipline internal and external aggression or punish swindlers. The only rational foundation of government is pragmatism, which ensures the general benefits of society (Bowley). Expediency requires extraordinary measures.

The issue of expediency is particularly true, in an increasingly integrated global political economy, which to paraphrase Strange is sailing in turbulent financial weather. In such a nervous global system where the task is increasingly complex, common sense and experience requires multiple hands on the rudder post. In other words, the global financial weather has become very rough, and needs multiple hands for its management, not only because finance is the established means of administering the liberal capitalist state, but because it is the central interstitial tissue in the integrated, nervous system of society, broadly construed. The optimal financial system in such a globalizing world is one that integrates the basic structures of national credit markets. In that sense, regulatory pragmatism would coordinate global politics and global financial structures. This can be achieved through application of the marketplace framework.

In short, the marketplace framework allows a more collaborative and flexible relational model between states and markets and between states and societies across political space. Tension as a defining analytical category, will have no meaningful role in the new global political economy. And in that sense, globalization will be managed for the benefit of all. This management model will reflect in the integrative structures of the environment, labor, finance, and global governance. We will then see what Cerny calls "transnational and transgovernmental co-operative regulatory institutions" that would manage globalization. Governance would consist of both "bottom-up" and "top-down" processes rather than only "top-down" approach. That requires engaging citizens in the values of the marketplace framework instead of the Janus-like structure of politics. Being a flexible mechanism, the marketplace framework provides confidence in governments and confidence in markets.

The confidence building process is evident in a joint curriculum-based financial literacy project that the SEC and the Financial Industry Regulatory Authority (FINRA) are developing for elementary schools in the U.S. This is a step in the right direction because such a project will allow the next generation to be educated about finance as too important (both in private life and in public realm) to be in tension with governments. The habits of mind to be inculcated will center around pragmatic regulatory coordination of the structures of finance and politics. After all, the project seeks to demonstrate that "teaching children about money [and finance] is an investment in the future" of the global political economy. Its acronym, CHANGE, stands for Creating Habits and Awareness for the Next Generation's Economy.[7]

The literacy project is a marketplace phenomenon for two interrelated reasons. First, the SEC as a federal financial agency is in coordination/collaboration with FINRA, a private, self-regulating market institution in devising and promoting that project reflects the marketplace framework. Second, the project theme: "creating habits and awareness for the next generation's economy," is what the marketplace framework stands for. The

[7] See the Securities and Exchange Commission, "Securities Regulators to Talk Financial Literacy with Students," November 13, 2009, available http://www.sec.gov/news/press/2009/2009-245.htm (accessed December 4, 2009).

next generation must understand the nature and importance of finance in every economy. Of course, Pinocchio has matured into a real boy at the crossroads of the worst financial crisis in history. The tension between states and markets will not be taught anymore because its rhythmic control of the "great game" (domestic and global) is changing for what it actually is: a façade of illusory appearance of markets as the only virtue.

With the marketplace framework, populist discontent towards markets as "natural target," or toward governments seen as "the problem," would be meliorated and people's energies directed towards productive ventures. Specifically, the marketplace framework has the potential of changing citizen's entrenched view of states as manipulative tools at the disposal of the lords of finance. In that sense, they will engage themselves in the democratic process. Doing so will be restoring as well as honoring their rationality, which has been appropriated to markets. The appropriation, in effect, has taken away the political nature of humankind. If "man is *the* political animal" as Aristotle puts it, then rationality is his/her "basic virtue, the source of other virtues." The marketplace framework will restore humankind at the center of state-market governance, and his/her rationality, rather than the rationality of markets, will be restored to the ancient truths of politics grounded more in social values than mere monetary profit.

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