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English summary

This thesis aims to contribute to a better understanding of the relationship between market structures and patterns of governance, to explain why attempts to establish a governance pattern that mitigates financial crises have been less than fully successful (to say the least). The central question informing the project is: *What explains the relationship between market structures and patterns of governance so as to understand the dynamics of the global financial system?* This general concern is explored by focusing on the issue areas of bank capital adequacy standards and the resolution of sovereign debt crises. The relationship between market structures and patterns of governance in both issue areas not only seems to be reciprocal, but also seems to be the key defining factor in developments in these areas. The past decades of cross-border and cross-sector integration of financial markets should therefore be understood as occurring symbiotically with the concurrent shifting patterns of governance. The overarching question above can consequently be broken down into three more specific research questions:

1. How has the pattern of governance shifted in the two policy domains of bank capital adequacy standards and sovereign debt crisis resolution over the period 1980 - 2005? How have the relevant market structures changed over the same period?
2. What are the characteristics of the policymaking process leading to these shifts in the pattern of governance of the two policy domains in global financial governance?
3. What is the role of the policymaking process in both shifts in governance and changes in market structure? In short, how do shifting patterns of governance relate to changes in market structure in each of the two cases?

These research questions are addressed by process-tracing the developments in the two policy domains, through an analysis of qualitative data (semi-structured interviews, policy documents, and archive materials) and quantitative data (market structure data of e.g. the BIS and OECD). The time period in which these cases are examined (1980 – 2005) allows for both within and across case comparison. In both cases, it can be observed that the changes in market structure which have occurred in the two policy domains ('globalisation of the financial system', reflected in bigger, international banks and increased capital market financing of emerging markets) have shifted the preferences of actors and led to the emergence of global-level public policymaking institutions in which private actors are closely involved. These developments facilitated the shift from 'public' governance at the international level (the governance patterns of Basel I and the Baker/Brady plans) to greater private sector self-regulation at the global level (the governance patterns of Basel II and the Collective Action

Clauses –CACs- plus Principles). These developments demonstrate that policy outcomes cannot be explained by state-centric approaches, but that internationally active private actors and the nature of their relationships to crucial state agencies need to be included in the equation. At the same time they demonstrate that the simultaneous globalisation of the financial system and development of new forms of multilevel governance is not driven by exogenous factors.

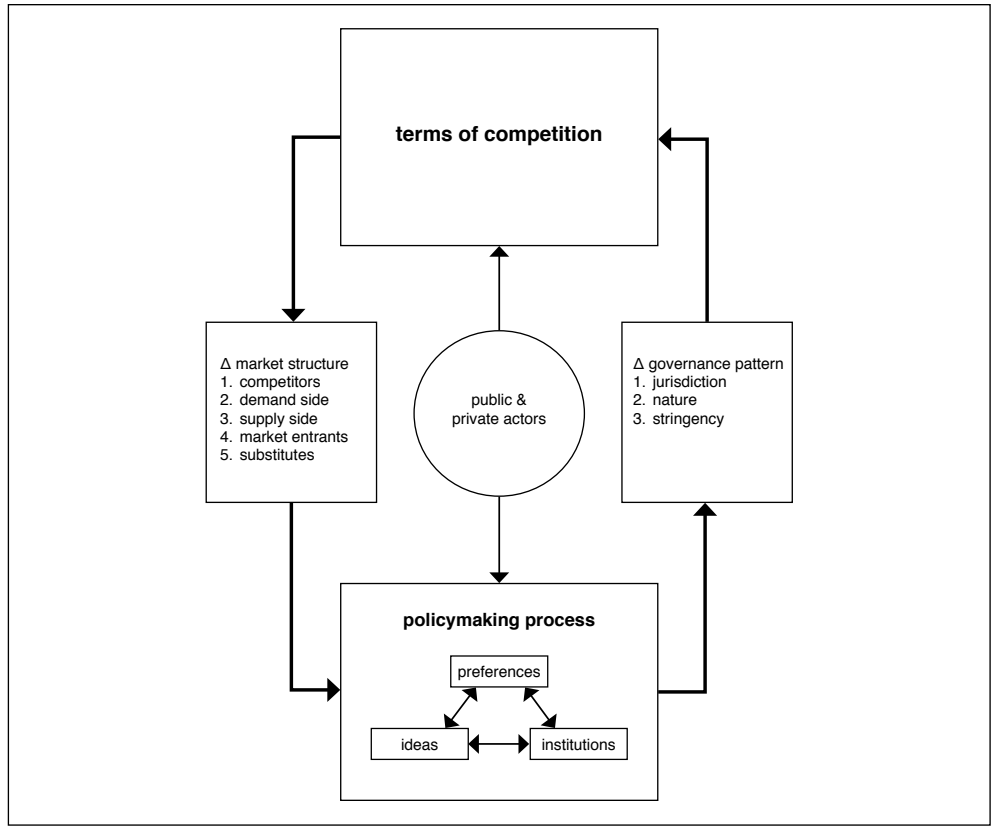
Furthermore, in both cases the shifting patterns of governance lead to changes in market structures and vice versa. The first global level agreement with respect to bank capital adequacy (Basel I) contributed to the emergence of diversified and international banks with sophisticated risk management practices. This shifted private actor preferences towards the use of in-house risk management models. Public actors followed this preference as they witnessed that this new market structure allowed for the 'gaming' of Basel I with the associated increases in risks. These shifting preferences led to the renegotiation of Basel I. In the case of sovereign debt crisis resolution, the Brady plan, which was developed to tackle the Latin American debt crisis of the 1980s, encouraged capital market financing of emerging markets. This diversified the preferences of private actors and led to a reduced sense of urgency to make progress on this issue. Public actors (specifically the IMF) realized the potential risks accompanying this new market structure for sovereign debt, however. These risks were brought home by the 1995 Mexican financial crisis and subsequent 1997/1998 East Asian crisis which necessitated sums of rescue funding which overburdened the creditor states. The IMF therefore proposed a comprehensive approach to sovereign debt restructuring (the Sovereign Debt Restructuring Mechanism, SDRM), which would entail a global level, public governance pattern for sovereign debt crises. The IMF's proposal was defeated by the influence of private actors in the policymaking process and the lack of support among debtor states, which feared their market access would be hampered by private sector responses.

Both cases also demonstrate that public actors continued to play an important role in the policymaking process. Their preferences reflected both a 'theoretical' understanding of how markets should function and their own market position (e.g. on the demand side of sovereign credit). As such, public actor preferences can counterbalance or complement sometimes more narrowly self-interested private actor preferences (e.g. the operational risk issue in the Basel Capital Accord or the emergence of a standard for CACs).

This analysis leads to two core arguments. First, at a general level, it is argued that there is a symbiotic relationship between the changing structure of the market and shifting patterns of governance: changes in the terms of competition lead to changing market structures which generate changes in actor preferences concerning regulation and governance, and the outcome of conflict over divergent actor preferences concerning governance and regulation (the shifts in governance pattern) generates new terms of competition and so forth. Changes in preferences concerning governance therefore appear intimately intertwined with preferences concerning the terms of competition. This feedback loop is shown schematically in the figure on page 235.

The second core argument is that public actors continue to wield crucial influence on the dynamics of the global financial system, even in the face of the huge growth of financial markets and its cross-border and cross-sector integration. Both public and private actors have an interest in global financial stability, and public actors are crucial in overcoming the collective action problems to achieve this. Furthermore, public actors have an important influence in the global financial system through their role as market players (e.g. on the demand side of sovereign credit). The debate on states in globalised markets seems to be misguided by its implicit state-market dichotomy. An integrated notion of changes in market structures and shifting patterns of governance points to the interaction between public and private actors: it is the collusion of public and private actors in the policymaking process that is the main force behind change. The preferences of public actors in this interaction are linked to their position in the policymaking process and their role as market actor. They hence develop their own position related to their position in the market. Although the policymaking institutions might change, the continuing importance of (certain) public actors in producing authoritative decisions regarding governance patterns does not.

The interaction between governance and market structure



In developing these arguments, this project makes a number of contributions to the academic literature. First of all, the relationship between governance patterns and market structures is conceptualised in a theoretically innovative fashion, overcoming the (implicit) dichotomy between the two which prevails in much of the literature. Overcoming the state-market dichotomy shows the limitations of a focus on either policymaking processes or market interactions alone, and leads to a better understanding of the search for optimal patterns of governance in the context of the realities of power relationships among a diverse range of actors which are simultaneously interacting on markets and trying to satisfy policy preferences. It contributes to the literature by bringing bundles of literature on financial governance from Economics, Political Science, and Sociology closer together, effectively bridging them in an interdisciplinary fashion. This contribution consequently has general relevance for International Political Economy (IPE) scholarship.

A second contribution, related to the first, is the attention paid to the interaction of both public and private actors in the analysis of global and domestic policymaking processes. This is a novel approach particularly at the global level: most studies of international policymaking processes remain either largely intergovernmental (neglecting non-state actors), or focus on private authority. By focussing on the interaction between public and private actors on both the domestic and global level, this thesis furthermore contributes to the debate on the role and agency of the state in globalising markets.

A third major contribution lies in the empirical process-tracing of the two case studies. Comprehensive studies, based on a consistent analytical framework, of the policymaking processes in the domains of bank capital adequacy standards and sovereign debt crisis resolution are wanting. Some literature has emerged discussing recent episodes in these policy domains (post-East Asian crisis and Basel II), but this has not yet been extended to the developments in the wake of the current financial crisis. Moreover, the thesis contributes to the existing literature by building on the historical context through tracing the developments in the cases from the Latin American debt crisis and the Basel I Capital Accord. This allows for a fuller and richer analysis of the complex causal chain which is developed in this research and which is crucial in understanding the dynamics of the global financial system.

Finally, as the current financial crisis gives new urgency to the two policy domains that are the focus of this study, a timely contribution to the policy debate can be made. The first step in achieving a governance pattern better equipped to promote stability is a better understanding of the realities and dynamics of the emerging global-level policymaking process and how this relates to the dynamics of market instability. The analysis of this thesis demonstrated where the room for agency lies; and consequently shows where we can steer the developments in governance to outcomes that are more closely linked to the public good of financial stability and the preferences of a broader range of stakeholders and citizens (as they should be in any democracy). The prime take-away message for policymakers should therefore be that the input legitimacy of financial policymaking must be improved. A wider range of stakeholders should be included, and it should be ensured that these stakeholders engage in substantive discussions on the trade-offs inherent in the global financial system. For example, one practical proposal to achieve this would be 'compulsory' consultations with a wider set of stakeholders. Such consultations would imply that the Basel Committee on Banking Supervision (BCBS) would not only put a consultative paper on its website and wait for responses, but should actively contact Civil Society Organisations (for example labour unions) to solicit their responses. The process should not be allowed to continue without wide-ranging inputs and a public discussion on what the BCBS intends to do with these inputs.

But this policy recommendation should not mean it is only up to the decision-making elites to improve the functioning of the global financial system. Individual citizens should have the opportunity to exit the global casino that has been built. Offering a wider and more transparent choice in the often opaque financial instruments citizens are consuming would empower citizens to make their own choice for the kind of financial system they want. Through such a two-pronged approach of an improved (global) policymaking process and improved opportunities for satisfying market demand of socially responsible financial products, policy space might be created to seek alternatives to the current global financial system and the unbridled expansion of market forces. Also, it brings us back to the prime message of this thesis that has relevance for scholars, policymakers and citizens alike: we should not think of politics or market behaviour when analysing the global financial system, we should develop an integrated understanding of politics and markets which can then be harnessed to design courses of action (on markets and in politics) that promote a global financial system that serves our common future.