The Public Good Versus Private Interests in the Global Monetary and Financial System

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Public domain, commonweal, public interest, public goods, national interest – busybodies through the ages (principally self-interested and often self-appointed authorities) – have tried to tell us as individuals what is good for us. Often ‘we’ resisted, sometimes calling into question the whole notion of a wider collective interest beyond the aggregation of individual preferences. In extreme situations zealous authorities have compelled individuals to fit, for better or for worse, into predetermined notions of the public good whatever the preferences of individuals. These attempts usually ended in failure after much unpleasantness, the latest example being the collapse of the Soviet Bloc and end of the Cold War. The social engineering capabilities of markets are proving rather more effective instruments of change as some of the transformations known as ‘globalisation’ would indicate, though because of the emphasis of free market advocates on individual choice the element of compulsion and the differential power of private actors in a market setting often remains obscured.

Yet the controversy surrounding the relationship between the interests of the collectivity, however defined, and the narrow interests of private individuals or corporate entities keeps coming back across a range of political cultures, whatever the nature of the political regime in place at a given moment. This is delicate ground to tread and the territory of the most vexing but fundamental questions for humankind. Freedom is indeed one of the great causes of all time

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and, perhaps as a result, is poorly understood by most. Few are the protagonists who can separate their analysis of freedom from their own particularistic causes or those of their immediate class, kin or ethnic/national group from which they draw their sense of identity. It is a hard truth that one person’s conception of freedom so often implies constraint for others. That we are all ultimately constrained in a variety of ways is something in which few indulge admission.

What better place to start than with the much misunderstood Adam Smith, who so long ago sketched out the problematic relationship between our selfish pursuit of individual interest, in particular private material gain, and the wider interests of ‘the public’ as a whole. How can we achieve collectively individual pursuits and selfishness? Somehow in all societies we know a sense of the public good emerges, socially constructed through an alchemy few of us would claim entirely to understand. Yet the notion of the public good emerges in different forms in different settings, underpinned by often contrasting notions of the public interest, embedded in the complex fabric of the political economy. It is tied up with the ways in which we sustain ourselves and the social structures which correspond to this; with the types of institutions and patterns of authority we establish to this end and to the objective of governance of our wider complexity; and with the ideas and contestations which we employ both to generate and justify these wider patterns of governance.

In her work on political economy, Smith was of course most concerned with a concept of the public good which contrasted with the private monopoly privileges and rent-seeking behaviour of the sovereign and his cronies, or others in structured in such a way as to overlook the natural talents and desire for achievement of individuals. Individuals knew their interests and how to achieve them better than any statesman or lawyer can for him. The statesman, who should not only load himself with a most unnecessary attention, but assume an authority senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it.

Once granted the freedom to choose their occupation and realise their sense of self-interest, this natural propensity of human beings could be exploited to the collective ends of wealth creation and distribution.

Nonetheless Smith was keenly aware of the tension between potential benefits for the commonwealth and the usually exclusionary interests of the individual. Successful implementation of such a scheme implied a strong notion of the public good and the need to make a clear distinction between narrow particularisms and the wider collective. Smith was acutely aware of the ways in which any class of society (yes, even capitalists) could constitute a clique similar to that of the king and his friends and would exploit its position to protect its narrow interests and thus damage the public good:

The sneaking art of underling tradesmen are thus erected into political maxims for the conduct of a great empire: for it is the most underling tradesmen only who make it a rule to employ chiefly their own customers.

3 Smith, cited in ibid., p. 268.
of capital, to a more market-oriented and globally integrated system characterised by a high degree of capital mobility, has involved a corresponding transformation in the notions of the public interest which underpin the operation of the monetary and financial system.

These changes in the financial system are bound to have an impact on any discussion of the public interest in which one might engage. Private market actors and pressures now dominate the making of national economic policies as well as regulatory and supervisory policy in the financial sector. The central purpose is to examine how this process of global financial integration and structural change has affected the changing balance of public authority versus private market power and interests in relation to public policy making in the domain of the monetary and financial system. The underlying argument is that the more market-oriented and transnational financial order which emerged in the past three decades has crucially altered the nature of public policy objectives and the way in which the 'public interest' and therefore the objectives of State policies are defined, with a corresponding impact on the way we conceptualise the public good. As regulatory and supervisory tasks have been rendered more complex and competing national jurisdictions increasingly unable to cope with the transnational nature of market structures, the tendency has been for policymakers to cede systemic risk management to firms and market forces. Furthermore, as States have increasingly ceded policy making autonomy to private market forces, traditional lines of democratic accountability and political legitimacy have been placed in question. For better or for worse the capacity of national governments to formulate economic and social policies in line with the preferences expressed in national democratic processes is considerably diminished relative to the first decades of the post-war period. Sometimes this was an act of State 'self-bondage' to resist the inflationary pressures of the democratic process; sometimes this was in response to powerful organised coalitions of interests promoting more liberal policies.

I. The Public Good and the Financial System

As the opening discussion indicated, Smith long ago laid out many of the important parameters of this difficult terrain. It would appear as idealistic to attempt
to determine the precise point at which individual interests and the public interest coincide – the exact dimensions of the public domain and precise definition of the public interest in any one issue area – as Smith thought it folly for would-be State planners to tell people how to employ their means. If we cannot precisely determine the exact nature of the public good, then we must at least make choices about the outcomes we prefer and the elements of governance which are most likely to get us there. In this sense, the distinction between the public good/interest on the one hand, and the legitimate realm of narrow private interests in the market on the other, has never been and can never be unambiguous. A complex mix of private interests either dominating or subordinated to public policy objectives can be observed, and one may at best conclude that a satisfactory balance of public and particularistic interests is vital to the successful and legitimate functioning of a market economy in a democratic context: satisfactory to the (rather indeterminate) imperatives of the national political economy in question. The dominance of democratic systems of governance by narrow market-based private interests can lead to severe problems of democratic legitimacy for incumbent governments and regimes.

If such an unsatisfactory situation were to prevail in the monetary and financial systems the problems can become acute. If financial sector and regulatory and supervisory processes become unduly dominated by private interests writing the rules for their own convenience and profit, we risk not only the legitimacy deficit but instability and crisis as well. Historically, financial institutions and market participants (unfortunately for my argument, this sometimes includes governments) have consistently shown themselves incapable of restraint in the face of temptations provided by a rising market in highly risky products, from real property to derivatives to LDC debt. The watchful eye of an external and objective authority with no interest in the markets itself has in many circumstances provided the necessary restraint on the herd, problems of moral hazard pending, though the existence of such is in itself no guarantee (supervisors can get it wrong). The disastorous consequences of mistakes in the financial sector for confidence in the monetary system include economic collapse or at least deep recession, increased distributional strife and economic hardship, threats to democratic stability, attempts by States to externalise the consequences in ways which negatively affect other national interests, and sometimes war.

So the notion of the public good and corresponding interpretations of the public interest has something to do with the need of political systems for legitimacy in terms of economic opportunity, institutions and modes of governance, and distributional outcome. A workable system can come in many different packages. Most are worked out painful over time and are under constant


9 Though I remain less convinced than Smith on this point. Private entrepreneurs (and sometimes public ones too) in the financial sector continue to exhibit tendencies towards self-destruction through the risks they are prepared to run for returns on their – sorry, other people's – money. Unlike in trade or production (the example Smith uses), this poses an ever-present though it is hoped remote danger of systemic collapse of the economy. Perhaps the financial sector is a unique exception to Smith's maxim in this regard.
The monetary and financial order adopted will be central to achieving any goals once defined because it is so fundamental to the way markets operate and to the distributional outcome. Under conditions of transnational integration, the monetary and financial system (and its associated national entities) will be structured largely along the lines of the way in which the provision of credit is created, allocated and regulated in dominant financial centres, or the ‘international organisation of credit’ as Germain refers to it.11 Who has access to credit, how it is regulated, and how stability is maintained will exert a primordial influence on the nature and characteristics of a particular economic system.12 But the policy process and practices which shape the monetary order as the basic infrastructure of the market system are far from neutral. Competing interests interact in a wide array of policy processes to shape the marketplace to their own advantage, creating a State–market ensemble of governance.13 Supervision and regulation of the credit allocation process have costs for the firms in the market and countries in the system, and the costs imposed will vary in relative terms depending on the nature of a firm’s business, the scale of its operations and the extent to which it operates across legal jurisdictions. Most long-run successful monetary orders have developed a clear sense of the public interest to maintain some version of stability, and this concept of public good is usually institutionalised in a central establishment with a substantial position in the markets yet with recognised (by State and market actors alike) objective responsibilities in terms of systemic stability and risk management. Such an institution, like the Amsterdam Exchange Bank (the Wisselbank) of the seventeenth and eighteenth centuries or contemporary national central banks in dominant financial systems, must have sufficient power in the markets and recognised political authority and/or legitimacy to provide rules for the market and standards in terms of conduct, to say nothing of lender of last resort refinancing facilities in the inevitable times of trouble.

The nature of all these provisions can vary and as they vary the outcomes in terms of stability versus innovation, the extent of direct State involvement,
the level of domestic versus transnational transactions, bank-based versus securities market credit allocation, the relationship of the financial sector to the real economy, and system of corporate governance will vary in turn. What kind of monetary and financial order do we want, and to serve what function/purpose in the larger picture of the ongoing economic development process? is the question we should be answering. Is the financial sector primarily for the speculative enjoyment and profit of financiers, with the systemic risk that entails? Is it primarily for the finance of State-initiated projects, from public investments to military adventures? Is it for the benefit of indebted landlords to continue to preside over chronic underdevelopment? Is it for the achievement of rapid catch-up industrial development? Is it a gigantic inter-generational borrowing scam (as some methods of State pension finance or the expansion of government debt appear to indicate), compromising the future of our children? Is it aimed at providing long-term investment capital for the maintenance of a competitive export-oriented manufacturing sector? What sort of outcome in terms of distribution do we want, as savings and investment will affect growth and productivity prospects and therefore wages and their distribution across the economy? What is 'our' purpose as a community and how will the financial sector best be induced/adapted to achieve this, bearing in mind Smith's invocations on the foolishness of what would-be social engineers and planners?

Much discussion of the global monetary and financial system ignores these basic questions and facts about how it is regulated, supervised and structured. Most accounts assume that the 'public good' is given as a deus ex machina; that it is self-evident in what the public interest consists with regard to the monetary and financial domain: reasonable control of inflationary pressures and basic systemic stability. Yet over the course of history and in the contemporary period we see very different financial systems in existence, each underpinned by a contrasting set of normative values and differing conceptions of the public good or interest. They may well be aimed at these basic goals in one way or another but achieve them (or not) in very different ways. In other words, a consensus in favour of maintaining the value of money and ensuring basic monetary and financial stability is insufficient as a definition of the public good in relation to the financial system. Each of these concepts admit of enormous discretion in terms of definition and implementation in constantly changing circumstances, and this discretion is usually exercised in relation to the material interest of those in a position to do so. Furthermore, as the questions listed above indicate, very different types of financial systems with contrasting notions of the public good at their core might accomplish successfully these policy goals but for very different reasons and in different ways. Financial and monetary system design thus involves a wider set of variables rather than much analysis assumes and affects a wide range of other characteristics of the political economy, including distributional outcome.

The definition of system structure and the terms on which the monetary and financial order work are characterised by the same sort of lobbying which goes into any policy process, but usually in very narrow confines. The policy community and the parameters of debate are usually narrower than in the case of, for example, macroeconomic or international trade policy making.

Particularistic interests of the financial services industry have a much greater chance of influencing the nature of the regulatory and supervisory system than you or I, not surprisingly. More wittingly, research indicates that they have a better chance than the average or indeed prominent legislator and members of government. Regulatory change leading to important transformations in the way that the financial system operates and the values it disseminates in national or global setting takes place in policy communities characterised by the prevalence of autonomous or quasi-autonomous agencies (for example, independent central banks) which (a) lie largely (though not necessarily totally) outside the normal domain of democratic accountability and (b) have close and relatively exclusive relationships with financial intermediaries and their associations. State agencies often lack the expert knowledge of fast-moving market environments which accrued to market players (indeed senior management often lauds knowledge of what their dealers are up to), and thus shared expertise and world-views were often developed in these confines with State officials in a dependent position.

II. Post-War Financial System Change and the Public Interest

The key question in relation to the discussion presented here is whether the monetary and financial system should be part of a public 'domain', or whether the public good would be better served should it be thought of as a private market affair. The brief version of the argument for the latter is that the workings of the market will better serve the public good because greater efficiency and stability is achieved.

As the debate between the 'gold' Republicans and the 'silver' Democrats about the merits of bi-metallism versus the Gold Standard in turn-of-the-nineteenth-century US politics reveals; see Galbraith, op. cit. n. 6, pp. 105–110.


The point about expertise was made consistently in a wide range of interviews with public sector officials. See also Underhill, 'Private Markets and Public Responsibility', op. cit. n. 8.


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ensured through the free interaction of economic agents in the financial sector and in relations between financial and non-financial firms. The likewise summary argument for the former is that the monetary and financial system is simply too so, and that the public good is better served by binding the financial Prometheus with a view to publicly controlled monetary governance.

Yet whether one sees the monetary and financial system as rightly in the public or the private domain, I doubt very much that, as per the discussion in the section I and the introduction to this article, that a clear and precise claim to agents can be made. With very few exceptions among the sane, even ardent need to provide public goods to avert market failure and help in the task of disclosure by firms to augment the provision of information, transparency in terms of price information, fraud prevention, and accounting and capital adequacy standards for prudential purposes. At the very least, while no firm they wish to know that their arm’s length counterparties (perhaps on the other are sound business partners). Authorities can also help by providing a clear expectations. These public goods could of course be provided in the main in terms of macroeconomic policy demonstrating sensitivity to market market disciplines in terms of self-regulation, though many would argue that removing such decisions from private hands is more likely to lead to the objective, disinterested fulfilment of these essential policy functions.

In short, there is little basis for the argument that the monetary and financial system should be placed exclusively in the private market domain. So what surely implies a State-owned and planned monetary order organised around investors. The record of centrally planned systems which did in fact organise undertake. Perhaps they would have worked better had other sectors in investment orders were subject to public sector control. But I suspect that the queue weight to the argument that the monetary and financial order is exclusively a monopoly. We might be able to design a co-operative-based or mutual-society-based financial system (credit unions, mutual trusts, building societies), and most national financial systems have some element of this, but these forms of micro-level organisation are today coming under increasing pressure.

Most existing national systems have a complex mix of the public and the private at work in terms of both market activity and the exercise of regulatory, supervisory and monetary policy functions. That these have evolved over time should provide us with a clue to answering the question posed at the outset of this section. The satisfactorily functioning of the monetary underpinnings of the political economy are of interest to State, market and the rest of us alike and in a democracy we are in fact all involved in each in one way or another. Because it is shared in this way, it can never be attributed exclusively to any of the three, each of which one might argue are ‘private’ in their own way, though State policy processes in a democratic context have the best claim to the provision of goods/assets in the public domain and to the underwriting of its ‘publicness’.

If this is the case, then when we speak of the monetary and financial system or order, in the overall sense, it is certainly part of the public domain. The public domain and the notion of the public good which stems from it is of interest to all. The fact that we so often tend to see public and private in opposition to each other relates to a conceptual flaw in our common understanding of markets. They are not a private domain, if Adam Smith is to be properly understood, but their successful functioning and the precise way in which they function is based on a concept of interest to the general public and will be intimately linked to our sense of community, morality and what it is to be human.

Market interactions are one of the important means through which we achieve public policy goals. State and market as a condominium should be seen as part of the wider pattern and institutions of governance, State and market as an integrated ensemble of governance, not as a tug-of-war one with the other. Markets can and should be aimed at achieving the public good, not operating counter to it, and must be made to do in a way appropriate to each historical and socio-political context. We should not identify the public good exclusively with what States do, nor the State exclusively with communitarian interests (especially given the capacity of private groups to appropriate the mantle of public legitimacy). The public good is necessarily bound up with our interests as private or corporate individuals.

To be more specific in relation to the monetary and financial system, the transactions are largely private (though with a substantial State element if for no other reason than that government debt issued by the treasury/central bank is usually the largest single chunk of the debt market), but the way the system operates as a whole makes it part of that essential infrastructure in the political economy, of such overwhelming value to State, market and the well-being of civil society, that it must be placed firmly at the heart of the public domain. Because this domain is essentially shared, what is needed is not a clear

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19 This point was corroborated thoroughly during extensive interview research with private and public sector officials alike.

20 Even in the US, which is often portrayed as a prototypical codified and statute-based system of regulation with strong authority vested in public agencies, front line regulatory tasks are often performed by self-regulatory organisations such as the stock exchanges or the National Association of Securities Dealers.

public–private distinction, but a clear definition of the public good/public interest in relation to the specific policy issues which touch on the monetary and financial order. We need to construct a notion of the public good and to develop the means to achieve it. If one values innovation in the markets one should aim at it; if one values stability one should aim at it; if one wishes a mix of these or other normative values, then one should aim at it but be aware of the necessary precariousness of any compromise.

It is these versions of the public good or public interest, and the means to achieve them in the governance of the monetary and financial order, which vary so strikingly from one national political economy to another. To decide what sort of monetary and financial order is desirable (and note the inevitable normative content of the choice), democratic systems must make clear decisions about the functions they wish the system to serve, as discussed in section I. They must furthermore have the necessary capacity in order to do so, or the monetary and financial order will consistently reside in the captive, private domain of market actors, not the shared space of the public. To make clear the public good in terms of monetary and financial governance can be defined and achieved in a variety of ways, and that models can only with difficulty, if at all, be transported from one historical context to another.

Thus there will always be a tension between private market actor preference and the public good in terms of global finance and monetary management. There is likely to be as a result an ongoing sharing of responsibility for the system by both market and State authorities, with substantial input from civil society. But the key point is that in a democracy the imperatives of political legitimacy certainly should, and are likely in the long run, to hold sway: if political compromises undermine the financial order, liberal policies are likely to be abandoned. Democratic choice can and should be exercised in the regulatory and supervisory policy processes which shape the system as well as in the domain of macroeconomic policy making. The trouble is that democratic choice seldom comes to bear in the contemporary context; instead these policy issues are too often viewed as matters exclusively for technocratic competence (and such competence is certainly a prerequisite), thus making a well-rounded definition of the public good difficult.

There are few occasions in history when democracies, or others for that matter, get the chance to start anew and to challenge the historically institutionalised assumptions about the public good which are at work in the monetary and financial order and over which private market actors have typically maintained such discretion and influence. One of these occasions was at the Bretton Woods conference in 1944 and the earlier Anglo-American negotiations on the post-war economic order. The failures of the Gold Standard and laissez-faire, along with the acknowledged benefits of a more or less liberal market system, were held up to scrutiny and fundamental choices were made. The Bretton Woods agreements sought to resolve the tension between pursuit of private gain and the realisation of public policy goals in a democratic context definitively in favour of public control of the monetary and financial order. The aim of the Bretton Woods planners was to ‘drive the usurious money lenders from the temple of international finance’. Private financial markets were to be at the service of national economic development and policy goals, not to dominate them, the better to ensure that financial instability never again undermined the political legitimacy of emerging democratic countries or endangered international security as had been the case in the inter-war period. Keynes also argued that State control of finance would also facilitate the maintenance of open trading relations.

The Bretton Woods compromise was greatly facilitated by the fact that most of the discussion was bilateral negotiations between the US and the UK. Others who were influential, such as the Canadian delegation, were also the advanced market economies of their day. Thus the differences among the economies and national interests of the negotiating parties were not as great as they might have been had more, and more diverse, parties been involved. Much has changed since Bretton Woods. Since then, regulatory change (often State-led), corporate innovation and the altered environment within which competition takes place dramatically transformed the characteristics of the international monetary and financial system from the 1970s onwards. We now have a much more global financial system than the nationally based order established in 1944. Developments such as the ‘securitisation’ of banking enhanced the importance of portfolio investment patterns, and the relatively short-term capital flows often associated with the development of such markets.

There are serious issues of public policy at stake, and therefore these changes have affected the public interest, altering for whom and for what the monetary and financial system order operates. The acceleration of short-term capital mobility has a considerable impact on the efficacy of domestic monetary policies and exchange rate policies. The impact on government debt management is no less pronounced, and investor funds have become vulnerable to increased market volatility. At the same time the traditional domestic regulatory and supervisory institutions overseeing financial market activities appear ill-adapted to a world of securitised banking and cross-border/cross-exchange trading in a growing variety of products. Many of these public agencies traditionally served
a financial system highly segmented according to specialised function and effectively cordoned by national political boundaries. The reshaping of domestic financial sectors through regulatory reform, corporate innovation, and the internationalisation of markets left traditional regulators caught in a tide of international transactions beyond their effective capacity to monitor.

If national regulatory and supervisory institutions and systems were under pressure, it seemed rational to expect these agencies to seek to co-operate with their overseas equivalents in order to increase the effectiveness of their policies and fulfill their respective legal mandates. However, the difficulties of known. This makes a co-operative definition of the ‘international’ public good seriously problematic. To complicate matters, it seems that States agencies often seek not just effective regulation and supervision, but also to improve market opportunities for national players and to enhance the attractiveness to investors of national financial markets. Thus the potential for regulatory competition is made possible due to differences in domestic market structures and types of financial institutions, differences in national regulatory and accounting systems used in defining the domain of the operation amongst central bankers. In some cases, international co-operation among national securities regulators is altogether a recent phenomenon with a few exceptions.

So many governments find themselves under significant external pressure in the making and implementation of monetary, exchange rate and financial sector policy. Private market pressures and interests now dominate the making of national macroeconomic policies as well as regulatory and supervisory regulatory agencies coincide less and less with the domain of the very markets and securities markets seem to call into question the established institutional patterns of regulation and supervision in a fundamental way. Effective co-investor/issuer protection, and compensation, or clearing and settlement practices, and this involves long and ongoing conflictual bargaining processes with a view to developing shared assumptions and approaches about the aims and objectives of regulatory and supervisory policies. Global integration is not a straightforward process, and nor is nurturing the public interest under such conditions.

As this discussion implies, these structural changes in the markets present a series of dilemmas and policy making difficulties in the context of a democratic system which one might at least argue puts the functioning of the monetary and financial system at variance with a sensible definition of the public good and due attention to nurturing the public domain. Some of these dilemmas are relatively well known so the discussion will focus on relating them to the changing conceptions of the public good which have accompanied the transformation in the structure of global monetary and financial space, and of the national systems which populate it.

Although States played a central role in the global integration of markets, policies have often borne a close relationship to the preferences of private market actors in dominant financial sectors, raising the spectre of regulatory capture as they spread their ‘universal’ practices throughout the world. An underlying assumption of the integration process was that the steady convergence of national systems in the integration process would require a steady convergence of regulatory, supervisory and macroeconomic policies. As standards emerged, however, they often did not fit the underlying diversity of national systems which remained hidden by the emergence of ‘global’ space. The predicted wholesale convergence did not take place, yet the policies of emerging international regulatory institutions in terms of either crisis management or supervisory practice takes into account this continuing diversity with understandable difficulty. Global integration is a growing and complex network of linkages among what remain fundamentally different financial systems designed to fulfill different roles in their respective national economies. Different financial systems will respond to uniform policies in different ways.

Policies must be sufficiently adaptable to suit a wide range of situations, and the objective of one policy for one global system, assuming this is ever seriously entertained, should be resisted. The pressures for policy convergence from global markets and from the dominant financial centres can undermine the sense that the non-financial and financial integration can work to the public good of, in particular, individual emerging market national economies. This new financial system is clearly more volatile than the earlier order, whatever its other merits might be. If public policy does not accept that for some time there will remain considerable diversity underpinning the integration process, then global financial integration will continue to produce crises which are managed in a way which is inappropriate to the many national economies in the system. Co-operation may become strained, and may break down over time. Public policy must not operate on the assumption that the global public interest is met in serving only the interests of the dominant financial centres, and sometimes even forgetting the interests of the non-financial and public sector there as well, given the ways in which the governance of the monetary and financial order affects us all and belongs squarely in the public domain.

Change has also come for the corporate sector: market segments of the wider financial services industry have become less and less distinct as a result of structural and institutional changes at the micro level. Specialisation is still an important feature of financial market activities, 27 especially in company stra-

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26 My argument is not that private market pressures and the interests of corporate actors were ever absent in the past-war or any other period, but that their role has increased.

egies where niche activities remain important, and in the labour market where specialised skills are necessary. Yet large banks and securities houses are now masters of vast financial conglomerates. This renders risk management in this key ingredient of the public domain complex and problematic. Regulatory and supervisory challenges in the industry reflect this development, and supervisors must monitor risk across several segments of market activity as well as across national jurisdictional boundaries. So must private sector risk managers; their task is greatly complicated too. The potential for spillover and contagion from one segment to another is commensurately enhanced, a situation which potentially puts the public interest at risk.

A key problem is that many national supervisory and regulatory authorities remain segmented along institutional or federal lines, or both (while for example the UK has moved to the 'one big regulator' approach), which makes in particular consolidated supervision of conglomerate firms more difficult. The counterpart to this development is that regulators and supervisors have sought to reinforce co-operation across jurisdictional and national boundaries, leading to bodies such as the Basle-based 'Joint Forum' of banking, securities and insurance supervisors. Such co-operation, however, remains inherently problematic, and certainly proceeds more slowly than the rapid reorganisation of the industry, and supervisors from different jurisdictions find that traditional rules and procedures often impede optimal co-operative efforts. Authorities at national and international levels should attempt to accelerate and deepen efforts at co-operation, especially in the domain of supervision and crisis prevention. Yet this co-operation must allow for a diversity of national financial systems and of definitions of the public good.

In this sense, policies should not be developed in the expectation of whole-sale convergence of national systems, nor of the emergence of a uniformly integrated global financial system. Global financial architecture will still need to be differentiated according to where and for whom it is built. Another question should also be confronted: that of the balance between regulation aimed at containing the risks taken by firms, and the supervision of the practices of firms in favour of a removal of restrictive, 'anti-competitive' regulation developed to contain market excesses and towards (at least where best practice is followed) the strengthening and adaptation of supervision to permit competitive market pressures to act as an instrument of risk management. Public authorities across a range of countries felt it was no longer their task to restrict what firms do in the interest of prudential behaviour by financial institutions, this being left to the market. We should at least reflect on whether this is not overly concerned and soundness in their self-interested private hands. States after all took over these responsibilities in the post-war period after the comprehensive failure of (albeit seriously underdeveloped) market-based and self-regulatory mechanisms.

As outlined above, regulatory change and rapidly adapting corporate strategies together have led to a less segmented, and more market-oriented, financial system than in the earlier post-war period. Tremendous growth in short-term capital flows and portfolio investments in sometimes complex and indeed exotic products have greatly complicated the problems of the international monetary system. States struggle to realise their macroeconomic policy aims in monetary and exchange rate policy. Major policy commitments of democratically elected governments have often been thrown into disarray as a result of the aggregate behaviour of global investors.

While this has been known for some time, less well known is the way these developments came about. The regulatory policy process was dominated by the private interests of major firms, which found ready respondents in State and central bank officials who shared their view in many respects. The regulatory policy changes which led to such considerable structural market changes were most often taken in isolation from any systematic consideration of the consequences for monetary and exchange rate policies – the evidence is very strong on this point. Regulatory policy change was perceived as necessary in order to enhance the efficiency of financial markets, and decisions were taken in close co-operation with the major players in domestic financial markets, often including foreign players. The difficulties which these structural market changes would present for the realisation of important policy commitments of democratic regimes were given little consideration. There was certainly little consideration of the problems of political legitimacy which market preferences in terms of macro policies might pose for domestic political regimes. If there was simultaneous consideration of regulatory and macro policies, often the surreptitious goal was to depoliticise important aspects of macroeconomic policy making, sometimes enhanced by creating an independent central bank. This formula worked as long as stability was ensured, but when adverse investor reactions to perceived policy errors led to crisis and instability, it was discovered that major economic policy issues remained stubbornly political despite the best efforts of technocratic configuration. The policies of international financial institutions (IFIs) have reinforced the difficulty in some cases.

In the (retreating) shadow of the Asian Crisis, this dilemma is felt acutely. Nonetheless there is a genuine loss of direction in policy terms. States and their agencies, as well as firms, are still learning about the changed environment. They realise they cannot go back, and that the new market structure greatly circumscribes options. There is considerable questioning in official but even in private circles of the so-called 'Washington consensus', but new approaches to management of the global financial system are still lacking. In this sense, the public good is lacking definition and needs urgently to be clarified by official and private authorities alike. The risk is that, as the crisis fades in the memory of at least the dominant financial centres, complacency becomes a palliative for the genuine bewilderment felt.

Furthermore, efforts to enhance global supervisory and regulatory co-operation, crucial for global risk management, have a perverse effect. By reducing risk and transaction costs through the harmonisation and co-ordination of standards, they may accelerate structural changes in the markets, with a commensurate impact on regulatory and supervisory dilemmas and on the making of macroeconomic policy. In the new market environment, I repeat, few regulators or supervisors believe that their policies should guide or limit
the development of the market. One must ask whether this accelerating pace of change permits adequate time for adjustment and for political systems to cope.

In supervision and risk management, then, the new environment has greatly complicated the tasks of both firms and official agencies in fulfilling the crucial functions of corporate and systemic risk management, yet these functions are central to any concept of the public good in monetary and financial governance. The principal result has been the emergence of 'market-based' approaches to supervision, wherein firms are responsible for risk management through complex mathematical risk management models implemented under criteria for the regulation and supervision of the markets, and in what constitutes the public interest? Crucial information and expertise for the process remains in a highly competitive environment there is also an intense need for firms to Level playing field concerns abound. This relative disarray in public administration and public definition supervisory criteria, and that this crucial aspect of public policy, the those private market-makers who benefit from it most. Public authorities are increasingly reduced to crisis management and (costly) lender-of-last-resort functions. The implications for moral hazard in crisis management should not go unnoticed. The mix of public and private is always a problem in any regulatory dilemma sharply in focus.

An example of this dilemma may have been provided by the recent draft proposals by the Basle Committee revising the 1988 capital adequacy accord. Most of the draft is to be welcomed with enthusiasm as it appears to be more need of the risk-based instrument of the original 1988 standards. Some attention is needed to be paid to the relative risks of different types of assets in banks' portfolios – we all know the difference between a Treasury Bill and a junk bond but there is much in between. It is also to be applauded that interest rate sensitivity of corporate disclosure standards, a responsiveness to financial innovation, and making capital standards more risk sensitive, are all positive developments. One might, however, be more sceptical about the proposal that supervisory authorities increase their reliance on market discipline as a tool of the trade.

Market disciplines have taken banks into many overly risky ventures in the past, such as the LDC debt crisis to which the original Basle Accord was in part a response. One also might question the proposal to make increased use of private rating agencies. In the developed country markets where information and rating agency expertise is fairly well established this might be fine, but elsewhere healthy scepticism is perhaps in order. We should bear in mind that a number have argued that the information available well prior to the Mexican and Asian crises was sufficient to warn prudent investors that capital inflows should slow down, but little heed was taken of this by industry analysts. Where were the rating agencies in the months leading to the crises, and what effects did they have on investor expectations? At the very least one can observe that the retreat by investors was far from orderly.

Finally, the proposal to allow 'sophisticated banks' (presumably the discredited Bankers Trust) was one of these, along with the bankers to LTCM (Long Term Capital Management) or the underwriters of massive Russian bond issues) used an internal ratings-based approach should at least give rise to further consideration, as no doubt will be the case in the consultation process set in motion by the Basle Committee. Encouraging sophisticated internal management controls is definitely positive, but increasing reliance upon them by supervisory authorities is of less merit. There is always a potential conflict of interest in a firm's internal assessment process, with a temptation to stretch standards to the limits to avoid misclassification. The proposals risk pushing supervisors out of the business of supervision, a potential move to add 'self-supervision' to the already common practice of self-regulation. Much will depend on how this aspect of the proposals is implemented in the final analysis, including the vetting and monitoring of internal control mechanisms by supervisors themselves. But to what extent once again should private corporate power be in on defining the public good in this vital policy domain?

The answer in many cases is reform of national financial sector regulation and supervision, and reform of the practices of national firms, the better to cope with global integration. Yet the financial systems of most countries are the result of long incubation, and historical differences from one to another remain considerable, as do differences in regulatory and supervisory policy. The functions of the financial sector remain differentiated: some are good at attracting foreign investment and allocating it to industrial development; some are better at providing crossroads for international portfolio flows and the recycling of capital in the global economy. Despite these

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28 Basle Committee on Banking Supervision, _A New Capital Adequacy Framework_ (Paper No. 50, June 1999). The draft proposals are currently the subject of extensive consultations with the private sector and with authorities outside the Basle Committee; see, for example, Institute of International Finance, _Report of the Working Group on Capital Adequacy: Response to the Basle Committee on Banking Supervision Regulatory Capital Reform Proposals_ (Washington, DC, March 2000); and Institute of International Finance, _Report of the Steering Committee on Regulatory Capital_ (Washington, DC, March 2000).

29 See the articles and debate concerning this question with regard to the peso crisis in J.J. Teunissen (ed.), _Can Currency Crises be Prevented or Better Managed?_ (Fondazione, The Hague, 1996).

30 See once again the response of the Institute of International Finance to the Basle proposals, op. cit. n. 28.

31 The Wall Street financier, Henry Kaufman, has raised this issue in articles in the financial press; see Henry Kaufman, 'Too Much on Their Plate?', _Financial Times_, 4 February 1999.
differences, the assumed model in most international regulatory or supervisory co-operation is of an open (transnational) capital market-based financial system. In many cases, national and international agencies have been unable to successfully address the subsequent ripple effects, clearly being questioned. Open capital accounts were considered to be beneficial, but external pressure from (usually creditor) governments and agencies ensured that private interests which wanted access to these markets, clearly revealed this pressure was, in view of the crisis to come, hard to contain.

The rush to capital account and other forms of liberalisation played an emerging market authorities had developed comprehensive and phased reform programmes leading to liberalisation, but these were undermined by local competition which liberalisation movement, and to join, the result was the worst of worlds: domestic sectors were not liberalised interests, and gave local institutions easier access to global markets and foreign currency dealings. This was a crucial factor behind the ensuing global financial instability. To add to the problem, it was often forgotten that liberalisation, as well, and this aspect of financial market development has received too little attention in the face of liberalisation often undertaken under external pressure. Patience and long-term planning is required if liberalisation and transnationalisation are to bring positive results. Liberalisation is likely to become greatly tarnished as a policy goal if it is not implemented cautiously.

Let us once again remind ourselves that the financial services industry within many countries constitutes an ongoing lobby to further liberalise and integrate domestic systems with the global. As mentioned, developed country pressure to change the nature of the financial systems of emerging market economies intensifies this trend. Research has little difficulty in establishing that powerful private interests were the principal interlocutors of official agencies in the development and reform of regulatory and supervisory policy. Of course, one would expect them to be involved but to be balanced by other actors in the policy process. Too often this is not the case. These private interests are simultaneously the object of regulation/supervision and chief counsellors in the formulation of official policy. In such a situation it is increasingly difficult to develop a notion of public interest or public good at the level of national or international regulatory institutions in global markets, at least beyond the obvious and very general goal of preventing a systemic crisis in global finance. There is an ongoing conflict across national financial sectors and among regulators and supervisors concerning the norms and values which should underpin the global financial system. Domestic regulators are still most responsive to their historic practices and to perceived domestic constituencies, and may champion the interests of national firms or valued domestic standards of regulation, thus impairing the effectiveness of co-operation. The objectives of participating domestic agencies are therefore coloured by their closeness to their market constituents in a situation which often approximates capture.

Given the ongoing enhancement of private agency and international listings in global governance, there is also a need to think systematically about the problem of accountability in democratic political systems. This problem affects the development process as well, at the very least because the problem of financial instability is most acute for vulnerable, emerging market economies undergoing fragile democratisation processes at the same time. If we can historically associate democracies with the relative absence of conflict and war, the political legitimacy issue needs to be taken more seriously in the policy process.

There is a tendency in a great deal of the economics literature and resulting policy advice generated at the very core of governments and IFIs to treat these political realities as unnecessary intrusions into the ideal of governance through market processes. If States and markets are both (as I have argued) integrated ensembles of governance, this attitude is a serious obstacle to addressing the problem of 'good governance' in the global political economy. Local norms and cultures cannot be wished away in this regard, especially if democratic choice is to have meaning in any ongoing fashion. Democratic societies will and should continue to differ in terms of policy mix and normative preferences. These points must be taken into account as we build policies for monetary and financial governance and reflect on the nature of the public good in this.

regard. Patterns of global governance must permit flexibility and patience as complex historical systems adapt to the pressures of the rapidly changing market. Nowhere is this more important than in terms of global financial regulation, supervision and monetary management. Given what is expected of political authorities, especially States, when financial crises strike, we cannot afford major crises which might be prevented by more cautious policies. The lessons of the 1930s need not be learned over again. That would certainly not serve the public interest under any definition.

III. Conclusion

These points should lead us to question the ‘bicycle model’ of liberal reform and market integration processes. The bicycle analogy (often invoked in relation to trade) compares liberal reform to a bicycle: one must keep peddling forward or one will inevitably fall off. Note the implication that bicycles do not even have a reverse gear. This implies that policy makers should charge forward, committing their societies and polities to a liberal utopia, so that none of us will fall off the bicycle. If we go fast enough we may also lose our temptation to jump as well.

Precipitous and ill-thought-out liberalisation of in particular the financial sector of any country in the global system can result in instability which discredits liberalisation itself. It probably has done already in a number of circles and countries. This may be one of the principal lessons of the financial crises which swept the globe from the middle of 1997. If liberalisation and the benefits its most ardent advocates proclaim is to be a sustainable policy, then greater attention should be paid to the very real political and social constraints on the liberalisation process. If liberalisation policies fall on infertile social and political ground, they could either fail to take root or wither at a later stage, with much unnecessary pain in the meantime.

In short, the financial liberalisation process should lead us to ask the broader questions about the ends of public policy in the domain of global money and broad visions like that of Bretton Woods have long gone in these (fortunateness, what exactly is the public good, the public purpose, in this era of global financial integration? There will doubtless be many answers, but the debate must surely be healthy. Liberalisation efforts in post-war trade took 35 years before even manufacturing industry tariffs came down to significantly lower barriers and trade in other sectors of the economy (agriculture, services) still await commensurate liberalisation and it will be a long process. The political obstacles to trade liberalisation are well known, but the delays have had a seldom-observed positive effect. All liberalisation implies restructuring processes, and if these happen too quickly, international co-operative agreements are likely to break down. The Kennedy Round tariff reductions were soon followed by a protectionist backlash in a number of sectors in developed economies. The long negotiation and adjustment periods which characterised the GATT/WTO process helped make liberalisation politically and socially acceptable. Societies, for better or worse, became more at home with the market, but this took a while.

Liberalisation efforts certainly smacked of political compromise, and there is nothing wrong with that. The imperfect world of compromise and constraint is the only one we have got, so let us make the best of it. Precipitous liberalisation in the financial sector could have rather less than pleasant consequences which would call into question what has been achieved so far, especially in societies which are not yet politically and socially prepared for the necessary adjustments. Liberalisation should be built on firm socio-political foundations, and we should think carefully what it is meant to achieve, or it will collapse. It is not an end in itself; it is supposed to be a means to a better world. If it fails to satisfy enough of the people enough of the time, then it will (and should) be discarded as a serious option in a democratic context.

So forget the bicycle theory. If liberalisation really is as good as advertised, then we had better take it slowly, and be prepared for lots of stops along the way. Let us also accept that liberalisation will never be a perfect state of affairs. We are unlikely ever to achieve a perfectly competitive market, or a seamless economic world without barriers to transactions of any kind. I am not sure we would want it; these are after all the abstractions of economic theory, not depictions of the world we actually live in. We can always have a better world, not a best one. The search for the best is not only likely to backtrack, but is also a worrisome utopian project.

Is ‘the power now exercised through the capital markets ... legitimate? Who gave the bankers increasing control over ... policies?’ The answer so far is ‘yes, but’, to the first question, and ‘States have no one to blame but themselves’ to the second. They bought it theoretical arguments which could be masqueraded as representations of reality though were never intended as such by anyone other than the most vulgar ideologues in the economics profession. They looked for easy solutions to the dilemmas which the 1970s presented and often chose market solutions because they eased the complexity of competing private claims in distribitional struggle. Most significantly for the financial services sector, States became increasingly captive of the self-interest of arguments of narrow coalitions promising greater efficiency and employment levels (neither of which were consistently delivered) in ways which masked the nakedness of their ambition to be free of regulatory and supervisory constraints. That democratic governments were so vulnerable to such arguments in albeit difficult circumstances is worrisome.

Of course the UK and the US adopted these mantras and aggressively shopped them around international organisations and through their bilateral contacts with others States, usually pressed by active industry lobbies seeking better access and market conditions in other countries. Many who might privately have thought better (correctly) saw the_sorted openness as a danger to illustrious careers. The fate of Joseph Stiglitz, the Chief Economist of the World Bank who was forced to resign at the end of 1999, is instructive here. Electorates colluded but have a substantive claim that they were fed imperfect information in the political process.

The point is, we had the knowledge, but declined to use it, that though what we were doing could provide undoubted potential advantages, it was problematic and had proved so in the past. Shared ideas in policy communities remain stubbornly linked to the dominant interests of our societies; the deglaciation objectivity on which we would like to pride ourselves is slow to emerge. In a self-satisfied and self-interested display of what can go wrong despite opportunities in terms of democratic debate and accountability, too many were along for the ride. B.J. Cohen has argued a parallel point to explain why governments are so hesitant to embrace capital controls in the wake of the Asian Crisis despite the evidence that they can indeed contribute to stability and serve the public interest, and therefore should be part of public policy. He argues that it is principally political constraints - the phalanx of IPIs, creditor governments and domestic coalitions in the financial sector - which lie behind such hesitancy.37

That these transformations in the global monetary and financial system might present long-term problems in terms of political legitimacy was hardly a given moment's thought. That this debate we are now in was thoroughly thrashed out at Bretton Woods so long ago, and a reasonable compromise reached, was forgotten. That some clear definition of the public interest distinct from the necessarily particularistic claims of transnational financial institutions could be expected of democratic processes remained a remote concern.

Perhaps a potential solution lies in a considerable strengthening of democratic institutions of accountability in our national, regional and global levels of governance, particularly in the economic domain. This is of course easier said than done, and would certainly run into the fierce opposition of transnational corporate interests which most enjoy the freedoms and profits of the global markets. It might also complicate a number of tasks in monetary and financial governance where speed is of the essence, such as crisis management, if efficient institutions are not established. It is, however, most unlikely that the powers of the corporate sector would be strengthened as a result of any such move. It is equally unlikely that the market and the pursuit of individual private gain would be abandoned either. Some mixed economy system would continue, though the balance might alter.