Markets beyond politics?
The state and the internationalisation of financial markets

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Abstract. The role of politics is particularly difficult to discern in the domain of international financial markets, where the state’s capacity to control or direct capital flows, without incurring considerable opportunity (and political) costs, appears so limited. In addressing this question, this paper argues that the process of internationalisation is first and foremost the consequence of political decision-making (to create open markets) and that many domestic interests linked to the international market have promoted internationalisation both through their policy preferences and economic activity. The paper will then go on to argue that the threat of financial instability and crisis, a consequence of the increased volatility of relatively unregulated capital flows, has prompted political demands for more concerted inter-state co-operation to maintain stability. Much of this takes place through transnational agreements among state agencies, such as the central banks, and much through ‘re-regulation’ in the guise of ‘harmonisation’ of regulatory and prudential supervisory policies.

Some of this process has received considerable publicity, such as the harmonisation of EEC regulations to facilitate freer trade in banking and financial services as part of the preparation for the Single European Market in 1992. Likewise, the current Uruguay Round of GATT trade talks has the liberalisation of trade in financial services on its agenda. Other aspects of the process have been carried on quietly, far from public view, in such forums as the Bank for International Settlements. Such is the case of a recent agreement to harmonise minimum capital adequacy requirements for banks operating in international markets. The paper uses these three cases to support the argument about the role of politics and the state in international finance.

There was nothing natural about laissez-faire; free markets could never have come into being merely by allowing things to take their course . . . laissez-faire itself was enforced by the state . . . To the typical utilitarian, economic liberalism was a social project which should be put into effect for the greatest happiness of the greatest number; laissez-faire was not a method to achieve a thing, it was a thing to be achieved.

(Karl Polanyi, The Great Transformation, p. 139)

This article represents an attempt to conceptualise the role of politics and the state in the development and functioning of international financial markets. The aim is to demonstrate the ‘political’ nature of the process which shapes the institutional context of international capital markets, and to examine the development of international co-operative efforts to manage the political
consequences of the relatively free operation of these markets. Three cases will be examined in this regard: first, the efforts of the European Economic Community to create a single internal market for financial services; second, the GATT "Uruguay Round" negotiations for the liberalisation of trade in financial services; and finally, the harmonisation of minimum capital standards for international banks through the Bank for International Settlements in Basle.

Markets have always presented an analytical problem for political scientists. The notions of self-regulation and automaticity which permeate the literature on markets implies the existence of a separate and autonomous sphere untainted by mercenary political interests. As Polanyi pointed out in 1944, the existence of a self-regulating market requires the separation of society into an economic and a political sphere (Polanyi, 1944: 71).

This was precisely the political impact of the classical economic theories of Adam Smith and his successors. Smith pointed out that by fostering and developing the market exchanges associated with the process of capital accumulation and industrialisation, society would become more prosperous and indeed egalitarian. "This at least would be the case in a society... where there was perfect liberty, and where every man was free to chuse what occupation he thought proper, and to change it as often as he thought proper" (Smith, 1937: 99). Smith's work was both an analysis of the emerging economic system associated with the rise of the bourgeoisie, and a political programme of policies 'to enrich both the people and the sovereign' (Smith, 1937: 397). He contradicted the French Physiocrats, who saw agriculture as the only productive sector, by extolling the virtues of the 'class of artificers, manufacturers, and merchants' (Smith, 1937: 639). For Smith, the promotion of free markets independent of political and regulatory restrictions provided 'the solution of a profound historical crisis' (Napoleoni, 1975: 46) associated with a stagnant residual feudalism. He believed that this new system would result in significant changes in the organisation and structure of European societies.

Indeed, the issue which underlies Adam Smith's seminal work on the importance of markets, The Wealth of Nations, is the need to square the circle, in ethical terms as well as in terms of economic analysis, of the tension between individual self-interest and the collective good. Smith believed that the pursuit of individual self-interest need not be a disruptive element in society. As Napoleoni noted, 'The Wealth of Nations represents a systematic attempt to explain how, so long as the necessary condition is met, the unfettered economic behaviour of individuals gives rise to the constitution and development of the socio-economic structure' (Napoleoni, 1975: 30).

Unfortunately for Smith's theories, the political success of laissez-faire contained the seeds of its own demise. The establishment of a market economy and society had unforeseen political consequences. The commodification of
labour in particular threatened the very humanity on which it rested, and ‘even capitalist business itself had to be sheltered from the unrestricted working of the market mechanism’ (Polanyi, 1944: 192). The market economy had required prior political conditions for its establishment and needed state enforcement to function. Thus the state found itself in the unenviable position of having to manage the political ramifications of the functioning of the very markets it sought to enforce. The operation of markets, which meant benefits for some and losses for others, was therefore the subject of political controversy.

Following the disaster of the 1930s Great Depression, post-war planners attempted to place market development on a more even keel at both domestic and international levels. The points made by Keynes in his devastating criticism of Britain’s return to the Gold Standard (1925) and his earlier Economic Consequences of the Peace were finally taken to heart in domestic economic policy. As Richard Gardner stated, it was largely accepted that ‘the liberal system could no longer be automatically achieved’ (Gardner, 1980: 2). Self-regulation would have to be replaced by international political agreements if a liberal world economy was to be re-established. The negotiations which led to the Bretton Woods monetary regime in 1945 and the GATT trading order in 1947 formed the basis of these agreements. They had to balance conflicting domestic interests with the need for international agreement (Gardner, 1980), and in some measure they are both with us today.

The eventual decision to develop a liberal international economic order was by no means a given. Even the most ardent proponent of a liberal world order, the American administration, was acutely aware of the ambivalence of the Congress on this issue (see ibid.: chs. 7, 8, 17). As liberalisation proceeded in the post-war period, often in a context of considerable disagreement and confrontation among the major Western economies, the level of economic interdependence increased as markets were extended across frontiers. In this way, the post-war agreements had provided the political foundation for the internationalisation of economic decision-making. The liberalisation of capital flows and of trade in goods and (to a lesser extent) services were the necessary preconditions of the globalised market economy which obtains today. Domestic economic interests have developed a considerable stake in the maintenance of this global economy through their participation in the ongoing process of internationalisation of trade, production, and capital. (Milner [1987] develops an argument and case studies illustrating the attitude of firms towards openness as these companies foster cross-cutting links with the international economy; according to her research, firms with well-developed transnational links resisted protectionist proposals.)

However, to return to the point made at the outset of this paper, the rapid development and extension of these markets into the international domain
presents analytical problems for the political economist. The roles of politics and the state are particularly difficult to discern. If state authorities consistently decide to respect market outcomes across political boundaries, do they not thereby grant at least relative autonomy to market forces? Where the opportunity costs, for domestic economies, of withdrawal from the world economy become virtually unconscionable for particular governments, how important in practical terms is the unity of the political and economic domains?

This conceptual dilemma is especially acute in the case of international financial markets. Their apparently unfettered growth, outside the regulatory framework of the state (e.g., the Eurocurrency markets; Versluysen, 1981) seems to give the lie to the apostles of political economy and to establish the liberal economists' case. Perhaps because of the greater political sensitivity of trade policy, financial interdependence has grown even faster than trade in goods. The state's capacity to control and direct capital flows in a meaningful fashion, without incurring enormous opportunity (and political) costs, appears remarkably limited. According to Bryant, 'The economic significance of national boundaries has been reduced by growing interdependence even as their political significance has been enhanced...the effective domains of economic markets coincide less and less well with national governmental institutions' (Bryant, 1987:3). This dilemma is felt particularly acutely in an international system of competitive states vying for economic and political power (Gilpin, 1987:238). While opting for market solutions, states attempt to manipulate the advantages and reduce the costs of interdependence.

Building on the concepts discussed above, this article will argue that, even in the case of internationalised financial markets, politics, through the medium of state decision-making, continues to determine the pattern of development. It will begin by demonstrating how political decisions and non-decisions led to the emergence of post-war international capital markets (essentially the Eurocurrency). Attention will then focus on two case studies of ongoing political processes which have as their object the extension of the role of markets at the domestic and international levels. These are, first, the programme of the European Commission to establish the single internal market for financial services; second, the GATT negotiations in the context of the Uruguay Round trade talks to liberalise world trade in financial services. The success of both these negotiations will require substantial changes in domestic policies and distributional outcomes. This involves transnational agreements among state agencies, especially central banks and finance ministries, and a process of 'reregulation' in the guise of the 'harmonisation' of supervisory policies and regulations governing financial institutions. The political and institutional setting of the international monetary regime forms the background of these efforts.

In keeping with the points made at the outset, a third case will demonstrate
the development of international co-operative efforts to manage the political consequences of the relatively free operation of international money markets. The threat of financial instability and crisis in the system (including the uncontrolled growth of debt and imbalances among the major economies themselves) are consequences of the relatively unregulated context of international capital markets and has prompted more concerted inter-state co-operation to maintain stability. This third case is the agreement negotiated through the Bank for International Settlements to harmonise the national capital adequacy requirements of banks operating in international markets.

All three cases involve the extension of the politics of market development into the international domain. The trend towards international economic integration, encouraged by state policies, requires international political co-operation if it is to continue. Thus not only have states had to iron out conflicts of interest among themselves, but they also had to muster the political resources to legitimate the agreements at home. Politics, far from being absent in the process of international market development, is both present and greatly complicated.

The internationalisation of financial markets

It is important to establish the historical links between political decision-making and market development in the post-war period. Considerable work has been devoted to the internationalisation of financial markets (Versluysen, 1981; Strange, 1985; Bryant, 1987), so a brief summary will suffice. What is most important in the context of this paper is the extent to which governmental action or deliberate inaction contributed to the initial context and subsequent expansion of international lending markets (Lipson, 1981: 607). US policies were particularly significant in this regard (de Cecco, 1986).

Initial developments were fairly circumstantial and haphazard. They related to the operation of the world’s monetary system and the political context of the Cold War. In the first place, the United States had created an outflow of dollars into the world economy with the Marshall Plan, other major aid programmes, and the enormous military expenditures associated with the Cold War buildup (Spero, 1985: 42). These dollars and the accompanying American balance of payments deficit, as the chief source of international liquidity, formed the basis of the eventual dollar overhang which underpinned international lending markets. A second stimulus was the decision to introduce simultaneous external convertibility of most Western European currencies in 1958. Convertibility brought European capital markets back into the open world economy, and provided an alternative to Wall Street and US control. Furthermore, Soviet and East European dollar deposits with banks
operating on offshore European markets, thus escaping American national jurisdiction in the context of the Cold War, provided an important catalyst for the initial development of the Eurocurrency markets (Versluysen, 1981: 22-33).

A central role in the development of these markets was, however, played by US banking regulations and capital controls in the 1960s. In the first place, restrictions on domestic dollar deposit short-term interest rates ('Regulation Q') provided an incentive to move dollars offshore. The growing dollar overhang associated with American balance of payments deficits was further (and ironically) encouraged by US attempts to stem the outflow of dollars from the United States. The Interest Equalisation Tax of the Kennedy administration (July 1963) was the first such measure. The Johnson administration's initially voluntary and eventually compulsory programme of capital export controls also pushed in this direction, respectively the Voluntary Foreign Credit Restraint Programme of 1965, and the Foreign Direct Investment Programme of 1968. The Withholding Tax on interest payments made by US institutions to non-resident customers likewise contributed to the growth of international banking. Banks found it profitable to offer deposits on off-shore markets, and large US corporations were moved to raise capital on these growing markets to avoid the restrictions which had been imposed at home on lending for overseas investments. Finally, the consistent and growing American balance of payments deficits of the 1960s were rapidly increasing the amount of dollars in foreign hands, steadily undermining confidence in the international monetary regime but fuelling the growth of the Eurodollar system.

London re-emerged as the principal (but not the only) centre of international finance. The British authorities were not neutral in this process. Despite the risks presented by the emergence of such unregulated lending activity, the British government was anxious to re-establish London as a world financial centre (Lipson, 1981: 607; Hall, 1986: 77; Strange, 1986: 14-5, 47). National restrictions on deposits and lending had led to the emergence of the markets in the first place, and it was hoped that benign neglect would ensure their further development. The recycling of OPEC petrodollars (Gilpin, 1987: 315-7) and the 'privatisation' of balance of payments financing in the 1970s (Lipson, 1981: 608; Llewellyn, 1985: 203-32) confirmed the trend towards internationalisation and gave a considerable quantitative boost to international banking and securities markets. The volatile circulation of capital which resulted brought the world to the brink of financial disaster, as major imbalances appeared in the world economy. The most troubling of these was the Third World debt crisis, but there was associated concern with the viability of major Western lending institutions which were heavily exposed on international markets. The potential political consequences of even a small-scale collapse put the question of regulation in the forefront once again (OECD, 1985a: 48).
Thus the emergence of apparently unregulated international capital markets was intimately related to political decision- (or non-decision-)making. It is not possible to separate the mediating role of offshore markets from political choices and commercial relationships, nor from the international political framework which circumscribes them (Lipson, 1981: 626). The process which led to the internationalisation of finance provides the backdrop for the major concerns of this paper: support for the position that, as Susan Strange put it, 'the management of credit is necessarily highly political' (Strange, 1985), and that the apparent erosion of national sovereignty where global markets are concerned does not imply the rise of markets beyond politics. The analysis will now turn to the case studies outlined in the introductory section.

I. Politics and the single European market for financial services

The decision to complete the process of building the internal European market in goods, labour, and services (began with the establishment of the Customs Union in 1968) as outlined in the Commission's White Paper of 1985 (EC Commission, 1985), involved a conscious commitment to dismantling or at least severely restricting national prerogatives in economic policy-making in favour of the construction of market decision-making processes and economic integration at the Community level. As such, it is an ideal illustration of the process of deregulation, reregulation, and harmonisation of national economic systems in favour of a more market-oriented outcome. It is also the clearest and most extensive example at hand of international co-operative efforts to extend financial services markets into the international domain. By tracing the decision-making process involved in the creation of a political framework for a single European market in banking and other financial services, it will be possible to highlight the political content of market development.

Of course, the original agreement to establish the Common Market can be seen in this same light. It was a bold political plan to foster a highly unnatural process of economic integration. The project was largely centred on artificial stimulants to develop a market system and society in Western Europe in order to avoid the contraction and conflict attributed to the protectionism of the 1930s. At first, there was considerable resistance to the idea of extending markets across political boundaries in Western Europe. By the early 1980s, however, further market development was seen as one solution to the growing problem of economic stagnation in the region, or 'Eurosclerosis', as it was called.

The decision to complete the development of the internal European market through the removal of physical, technical, and fiscal barriers to the free movement of goods, capital, services, and labour was the culmination of a long
process of debate and procrastination. By the late 1970s, it was generally perceived by the Commission and member states alike that the process of European integration had stagnated and indeed deteriorated into a series of unsightly wrangles over budget contributions and the Common Agricultural Policy (for the Commission’s rationale, see EC Commission, 1984: 2-8). Economic crisis and declining competitiveness in advanced industries contributed to this perception (Pelkmans and Robson, 1987: 181).

With regard to the liberalisation of capital movements, only limited progress had been made in the early 1960s, and this related largely to capital movements associated with trade in goods and services (EC Commission, 1984: 6-8). Despite this relatively poor record, considerable momentum was generated in the early 1980s. This was symbolised by the Solemn Declaration on European Union of July 1983, and the draft treaty establishing a European Union issued by the European Parliament (Lodge, 1986: 203). This progress was consolidated by the convening of the Intergovernmental Conference on European Union in July 1983 and the approval by the Council of the Single European Act (EC Council, 1986) in 1985. Also in 1985, the Commission’s White Paper Completing the Internal Market (EC Commission, 1985), accepted by the Council in June of that year, linked declarations of principle to a series of concrete steps towards greater economic integration. It is on the provisions for the integration of capital markets and the liberalisation of trade in financial services, and on progress so far, that we shall concentrate.

In the first place, the move towards the completion of the internal market has not taken place in a political vacuum, and indeed the impetus goes beyond agreements among the member states. The business community in EEC countries sees a very clear connection between the completion of the internal market and improvements in competitiveness on European and international markets (Pelkmans and Robson, 1987: 184). As Lord Roll of Ipsden, Chairman of S.G. Warburg and Co. was to comment in 1982:

... when one looks at the real economic situation of the world and when one looks at the financial and banking problems, which are only the most acute expression of the economic malaise in which we find ourselves, one must conclude that a far, far greater effort of international economic co-operation is needed in which international institutions, central banks, and the banks themselves, as well as governments have to be involved. Infrequent, short summit meetings are no substitute. (EBF, 1982: 12)

European efforts in this regard would complement other modes of international co-operation for the liberalisation and international regulation of capital markets.
In the domain of financial services, given the already high level of internationalisation and integration of world markets, the connection between enlarging the internal market and the successful competition of European firms on a global scale must be very clear indeed. The Commission expects that the main beneficiaries of, for example, a single banking market, will be business, not individuals (exceptions to this expectation may be mortgages and consumer credit; Fitchew, 1988: 10). Implicit in the Commission’s strategy is the idea of a ‘supply-side shock’ essentially aimed at business managers: ‘Costs will come down. Prices will follow as business, under the pressure of new rivals on previously protected markets, is forced to develop fresh responses to a novel and permanently changing situation’ (Cecchini, 1988: xix, 91). In financial markets, there will be a ‘competitive shock administered to overpricing in the wake of market integration’ (ibid.: 95). Lower costs for capital would spill over into the manufacturing sector as well, amplifying the basic effect and reinforcing the drive to greater competitiveness and contributing up to an extra 1.5% to Community GDP and with a deflationary impact on price levels and debt burden of around 1.4% and 1% of GDP respectively (ibid.).

The policy implications are also considerable. The liberalisation of capital flows has clear implications for monetary policies and balance of payments adjustments, and there will be increasing pressure to improve the co-ordination of macro-economic policies in general (Pelkmans and Robson, 1987: 191). Such instruments as exchange controls were recognised as being less and less of a guarantee of policy autonomy, as economies became increasingly interdependent (EC Commission, 1984: 22). Also involved would be, in the words of Commission President Jacques Delors, ‘the parallel approximation of the rules of prudential management and basic rules for banks and other financial institutions’ (Delors, 1987: 32).

These, then, were major political decisions which would have to be agreed within and among states in a policy domain which was particularly sensitive in a period of economic instability (especially where safeguard measures were concerned [EC Commission, 1984: 23]). It involved nothing less than the ‘creation of a framework of law and taxation to promote financial integration and equity capital financing’ (EC Commission, 1984: 27), in addition to harmonising regulations on banking and insurance services. The goal was clearly that of increasing the competitiveness of European financial institutions and capital markets for global competition. This was important in itself, for the financial services sector accounts for about seven per cent of European GDP. Not only that: the financial sector, as a crucial support and input for industry, was seen as vital to oiling the wheels of the competitive market economy in a more general sense as well (Fitchew, 1988: 4–5). The harmonisation of the regulatory framework and ‘the decompartmentalisation of financial
markets should boost the economic development of the Community by promoting the optimum allocation of European savings' (EC Commission, 1985: 33).

The Commission’s Directorate-General for Financial Services and Company Law identified three key elements of integration in the financial services sector (Fitchew, 1988: 5). The first was of course the basic provision of freedom of capital movements: '[t]he obligation on all Member States will be to ensure that its residents have access to the financial system of another Member State and all the financial products that are available there; that there are no restrictions on capital transfers and that there are no discriminatory measures e.g. fiscal discrimination’ (Fitchew, 1988: 6). Particularly important is the free circulation of ‘securitised’ financial instruments not quoted on stock markets, including unit trusts, bonds, long-term commercial credit, and unquoted securities. Directives liberalising these transactions have already been implemented (EC Commission, 1988.a, Annexe 1: 24; also EC Bulletin, 21/6, 1988: 20, 22–3). This includes some final legislation for the liberalisation of capital movements which would amend and regroup existing EEC measures for ‘medium term financial support of Member States’ balances of payments’ (EC Commission, 1988a: 20). This was approved by the Council on 13 June 1988 (EC Bulletin, 21/6, 1988: 20). All directives concerning transactions in stock market securities, including the regulation of insider trading, equity flotation prospectuses, disclosures of shareholdings, and other investment services were expected to be implemented by the end of 1989 (EC Commission, 1988a, Annexe 2: 13–6; Annexe 3: 10).

The second element of the strategy is the freedom of establishment of financial institutions throughout the Community. Here there must be provision for the harmonisation of licensing procedures for institutions, of prudential supervisory arrangements, and ‘mutual recognition’ of the way in which member states apply these common standards so as to ‘co-ordinate the conditions under which financial intermediaries operate’ (EC Commission, 1985: 33). Basic common standards must be negotiated in order to accomplish this objective. However, there had to be a way of limiting the enormous political and technical difficulties of financial market integration and the liberalisation of trade in financial services, or the negotiation process would have become overburdened. The basic principle adopted in the White Paper for dealing with this problem was the same as that for other sectors – ‘Home Country Control’ (EC Commission, 1985: 27; 1988a: 24–5; Fitchew, 1988: 7). To take the example of banking, a single banking licence (based on the common standards) will be issued to a bank by its home country supervisor. This will authorise the bank or other financial institution covered by the directives to set up branches in any other member state while depending on the authority of its home central bank. This reduces the administrative complexity of integration
for each member state, but provides at the same time an ongoing incentive for further harmonisation of state regulations, for otherwise banking or insurance services will tend to migrate to countries where supervisory control is most lax.

As in the case of the liberalisation of capital movements, the Commission’s work in this domain is by now well-advanced. The Director-General of Financial Institutions was able to claim that in 1988 freedom of establishment for banks was more liberal in the European Community than in the United States (Fitchew, 1988: 8). Measures concerning the granting of single banking licenses, common solvency (capital adequacy) ratios, bank accounting procedures, and bankruptcy/insolvency procedures were just a few of the undertakings outlined in the White Paper, and the Second Banking Directive implementing these measures was approved by the Commission and transferred to the Council on 13 January 1988 (EC Bulletin, 21/1; 1988: 12–3). Approval of most of these measures was scheduled for 1988 or 1989 (EC Commission, 1988a, Annexe 2: 12). As far as the insurance sector is concerned, freedom of establishment was, technically at least, implemented in the 1970s. Much work to create a genuine internal market remained, however. Measures covering legal expenses insurance and credit insurance were approved in 1987 (EC Commission, 1988a, Annexe 1: 21). A major benchmark was passed on 22 June 1988 with the Council’s approval of the Second Co-ordinating Directive on Non-life Insurance (European Communities, 1988), for implementation within two years of its date of notification on 30 June 1988 (EC Bulletin, 21/6. 1988: 55). Further directives concerning insurance contracts and undertakings are being introduced for approval in 1989 (EC Commission, 1988a, Annexe 3: 10). A number of issues remain to be resolved in such areas as motor liability insurance and life insurance.

The third element of the Commission’s strategy is to provide for the freedom of provision of financial services in the absence of an establishment (Fitchew, 1988: 5). Many of the measures providing for harmonisation of regulatory provisions and practices also apply to this, as does the principle of home country control. For example, the Second Banking Co-ordination Directive provided for ‘any authorised credit institution to supply banking services in any Member State either by branches or by means of the provision of services’ (my emphasis; EC Commission, 1988a: 24). Banks, and for that matter securities firms, will be able to offer their lending, deposit, and intermediary services across borders under a single regulatory regime underpinned by the freedom of capital movements. Provisions for the insurance sector were similar.

In the case of the European Community’s efforts to remove the remaining barriers to the completion of the internal market in financial services and to liberalise capital movements while maintaining adequate and common standards of regulation and supervision, the process of decisionmaking and implementation is well advanced. The goals of greater competitiveness for Europe-
an financial markets in a global context, and as a vital support for the competitiveness of European industry, are clearly expressed, and the lengthy debate and procedures of the policy process allow us to see the step-by-step implementation of legislation to bring this about. The role of politics and political institutions in this process of deregulation and re-orientation towards global markets is difficult to deny. The state and Community institutions are actively creating markets where none or only rudimentary ones existed a few years before.

Although the member states may be seen as responding to market pressures which had been developing for some time, these same states, along with the US, had been largely instrumental in encouraging the establishment of an open economic order and monetary system which provided the underpinning for successful market development. Many important economic interests in these countries are now identified with the maintenance and indeed expansion of these global markets, particularly in the financial domain. In any event, the new legal and regulatory framework is clearly identified as vital to the successful development of markets—not as means to an end but as something to be achieved, to echo Polanyi. Supervisory provisions complete the circle—the market economy requires state enforcement to function, as well as a political framework for its establishment. It remains to be seen what the political consequences of the new European Community programme will be, but there has been continual concern about the need to provide adjustment assistance through the Social and Regional Funds in addition to national programmes (EC Bulletin, 21/5, June 1988, point 1.1.1 and subsequent).

II. The Uruguay Round and the liberalisation of trade in financial services

The efforts of the major industrialised nations to regularise and liberalise trade in financial services through the GATT is still in its infancy. Less formal agreements concerning trade in services, particularly banking and securities, have, of course, been under negotiation for the last thirty years or so under the auspices of the OECD, and in recent years these efforts have been accelerated (see OECD, 1987c: 47–51), a phenomenon which should be seen as part of the general context of the Uruguay Round negotiations on trade in services. It is perhaps unreasonable to draw too close a parallel between the more developed efforts of the Community in a similar vein and the larger, multilateral effort of GATT negotiations, but some comparison is surely invited. One may also assume a link between Commission policies concerning the internal European market and the Community’s policies with respect to the world trading order.

The objective of an expansion of trade was one similarity. National service
sectors have traditionally been highly protected, and it is estimated that world trade in services would have grown faster but for the many barriers to transactions (GATT, 1984: 18). As European Commissioner Willy De Clercq asserted, '[t]he level of international trade in services stands at one quarter the level of trade in goods; services today constitute one of the most dynamic features of the world economy' (speech to the GATT ministerial gathering at Punta del Este, Uruguay, 16 September 1986: De Clercq, 1986). Given that many of the remaining barriers to trade in goods would be difficult to dismantle, because of the contentious nature of the adjustment process, a consensus emerged among the industrialised nations on the desirability of developing markets in what had become the fastest-growing sector of most industrialised economies (Shelp, 1987: 76, 79-80).

Also parallel to the EEC case, the new round of multilateral trade negotiations was motivated by the ongoing economic difficulties of the industrialised economies. The extension of international markets into new areas through co-operative intergovernmental action, specifically trade in agriculture and services, was seen as a potential stimulant to growth (GATT, 1986: 17, 21; GATT, News of the Uruguay Round, 003 [16 March 1987]: 5). GATT economists have also stressed the important links between the 'provision of services and merchandise trade', and that 'access to competitively-priced producer services is increasingly important in determining the ability of firms to compete at home or abroad' (GATT, Press Release 1463 [5 September 1989]: 1).

The US interest was clear: America possessed the largest service economy, with over 75 per cent of the workforce and 69 per cent of GNP dependent on service industries, and a spectacular record of job creation to accompany this fact. The services account of the balance of payments has typically been heavily in surplus, but US export performance in the sector was three times below the collective service exports of EEC countries (Shelp, 1987: 76-9). The Reagan administration, upon assuming office in 1981, was particularly anxious to deal with this issue, believing that the American economy had a comparative advantage in financial services in particular (Gilpin, 1987: 333; GATT, 1984: 5) in a context of declining US trade competitiveness in manufactures — although, ominously, North America showed the fastest growth in services imports in 1987, about 9% per year (GATT, Press Release 1463: 2).

In sum, new initiatives in an international forum to expand the scope of the international market for financial services were seen as a way to relaunch the apparently moribund GATT and the world economy. The goal was to establish a multilateral framework of principles and rules for trade in services, including elaboration of possible disciplines for individual sectors, with a view to expansion of such trade under conditions of transparency and progressive liberalisation and as a means of promoting economic growth of
all trading partners and the development of developing countries (GATT, 1986: 21).

This would, however, be controversial. The intention of the United States was to apply the GATT principle of ‘national treatment’ of foreign goods on the national market to foreign suppliers of services. ‘Such a definition would logically carry with it a foreigner’s “right to establish and right to do business”’ (Mark and Helleiner, 1988: 21; emphasis in original). This is because the effective provision of services is linked to a presence in a market: they cannot be stored or shipped. The need for service suppliers to establish such a presence represents a challenge to immigration restrictions, investment and financial control policies, and issues of international factor mobility (ibid.: 20–1; see also OECD, 1987d: 3–6, 9–11 and 16–8).

Some of the most important elements of trade in services are banking, insurance, and securities (OECD, 1987d: 6). The OECD has paid considerable attention to these in the past few years through its Committee on Financial Markets. The emphasis has been on promoting liberalisation of national policies, with respect to outside involvement in national financial services industries. So far, the effort has been principally focused on studies to identify obstacles to trade in these sectors, where reliable data of any kind is notoriously scarce (Shelp, 1987: 65–7; 76–9). This OECD effort was in addition to national studies which were carried out on behalf of the GATT Secretariat (e.g., GATT, 1984). Support for liberalisation, as the governments of the advanced economies began to realise the potential benefits for their economies, had been growing. There developed a consensus of sorts among the EEC, Japan, and the US and Canada that the issue should be vigorously pursued in GATT (Shelp, 1987: 80–1). The OECD Trade Committee had even developed a conceptual framework for trade in services similar to that which underpins GATT rules for trade in goods (OECD, 1987a); this fitted in with OECD codes of practice on liberalisation of capital movements and trade in invisibles (Shelp, 1987: 70–1). In this way the issue was placed on the agenda of the Uruguay Round trade negotiations by the ministerial gathering in September 1986, despite fairly intense opposition from many of the developing countries (Shelp, 1987: 64).

As with earlier multilateral trade talks, the Uruguay Round negotiations were broken up into a number of Groups on Negotiations, of which services was one (GATT, 1986: 21). At early meetings (23–5 February 1987) and subsequently, the very principle of liberalisation of trade in the services sector was the subject of a wide-ranging debate (GATT, News of the Uruguay Round, 001 [16 March 1987]: 4). Opposition from the LDCs was not the only obstacle. There were genuine conflicts of interest at stake among the more advanced nations, with potential winners and losers. The GATT negotiating countries all
had quite different banking industry structures. In the case of the United States, foreign banks were limited in their ability to establish full-scale banking operations across the country. This is largely due to the individual states' power to prohibit foreign banks from setting up establishments within their jurisdiction (GATT, 1984: 49). Liberalisation may upset the balance of political power between the levels of government in this regulatory domain, something which the states may be unwilling to countenance (Shep, 1987: 78).

Liberalisation would also interfere with established patterns of prudential supervision in national banking industries. As the OECD put it,

A fundamental issue . . . is the extent to which market responses to signs of strains developing in an institution can be expected to develop in a way congruent with the overriding public policy objective of preserving the integrity of the financial system . . . Indeed, concern has frequently been expressed that over-reliance on public disclosure and market discipline might lead to further instability in the financial system as a result of over-reactions by the market to actual or perceived changes in a bank's situation (OECD, 1986: 22).

In other words, 'marketisation', or asserting market discipline as the chief measure of the success or failure of an institution, alters the traditional, regulated pattern of risk-taking. It may impose significant costs on some historically solid institutions which based their stability on a particular prudential regulatory framework, now torn asunder. Yet an increase in private (i.e., market) risk control is a necessary complement of the extension of markets if distortions in competition are not to occur among various national industries. Indeed, the extension of markets in banking has already struck at the heart of national systems of monetary control, sometimes impairing its very effectiveness unless there are accompanying measures of co-ordination among states (OECD, 1985a: 4). These are only a few of the issues surrounding the negotiations over liberalisation, and it is likely that initial efforts will be limited as a result. The threat to the infant financial sectors of Third World countries is commensurately greater.

As far as trade in securities is concerned, most markets have been national in dimension and, consequently, the almost exclusive preserve of national firms (OECD, 1987a: 16–7). Inadequate capitalisation and expertise has, in many cases, rendered these firms inappropriate for international competition on the expanding global markets. The frenzied pace of merger and joint-venture activity associated with the City of London's 'Big Bang' (27 October 1986) is an example of the sort of adjustment which liberalisation may bring to most markets. In the City, the doors were thrown open to all for membership of the Stock Exchange (Stonham, 1987: 8), and market-makers faced intensified
competition and smaller returns on capital, with consequent downward pressure on profit margins (ibid.: 15). Foreign dealers, especially the Japanese, moved into new positions of prominence, and old and venerated City institutions were merged or gone forever. Even newcomers suffered: the investment dealing operations of both the Midland and Lloyd's banks, set up to profit from the Big Bang, had to beat a hasty retreat in 1987 (ibid.: 16). There is little reason to suspect that accelerated liberalisation will not bring similar upheavals in other markets.

If these are the very serious political and economic conflicts of interest which may be linked to the extension of markets in the financial services sector, what has been accomplished by the Uruguay Round? There were, in fact, five main elements to the negotiations: 1) definitional issues (what constitutes trade in services (see Shelp, 1987: 56-9); 2) statistical issues and the development of a comprehensive data base (statistics gathering in trade in services is severely underdeveloped compared with trade in goods); 3) a conceptual framework on which rules and procedures in trading relations might be based; 4) what specific service sectors the agreement would cover; 5) which measures and practices limit or encourage the expansion of trade in the sector.

Apart from disagreement over the very principle of international regulations for trade in the sector, there was initially no consensus on either a definition of trade in services or the development of a comprehensive data base (GATT, News of the Uruguay Round, 006 [8 July 1987]: 2-3). The negotiations also sought to deal with the inherent tension between the objective of liberalisation and the commitment, in the original Punta del Este declaration (EC Bulletin, 19/6, 1986: 21), to accommodating the policy objectives of national laws and regulations applying to service sectors (GATT, NUR, 014 [24 February 1988]: 4). This was particularly important to the European Community, and conflicted somewhat with the more far-reaching American proposals (summarised in GATT, NUR, 012 [10 December 1987]: 5). Likewise, the developing countries were concerned about the status of their emerging service sectors and their role in national economic development.

The third point, concerning the conceptual framework, proved to be the most controversial, and stalled progress on points four and five. It had already been established that fundamental GATT rules and procedures would apply to the negotiations. In particular, 'national treatment' would obtain, which meant that the regulatory and fiscal treatment of imported services would have to be broadly equivalent to those produced domestically (it would also mean, as noted above, that foreign suppliers of services requiring a presence in local markets in order to 'export' their services would have a right of establishment); so would the principle of transparency (Shelp, 1987: 76). There were, however, many outstanding issues when it came to applying this general frame-
work to individual service sectors (GATT, NUR, 006 [3 July 1987]: 2–3). Of considerable concern was the question as to how far the principle of reciprocity, the original basis of GATT rules on trade in goods, should be extended in the domain of trade in services. The American proposal called for the extension of this principle as far as possible (GATT, NUR, 012 [10 December 1987]: 5), but a Swiss proposal, which received considerable attention, floated the idea of ‘optional most-favoured-nation-treatment’ (GATT, NUR, 013 [21 December 1987]: 5; GATT, NUR, 014 [24 February 1988]: 3), clearly an attempt to bring along the LDCs. (This idea was later echoed in a submission by Mexico as ‘relative’ reciprocity [GATT, NUR, 018 (2 August 1988): 12].)

There still remained the underlying issue of the very principle of international rules for trade in services. The GATT ministerial gathering in Montreal in December 1988 did achieve some form of progress. The report to the ministers by the services negotiating group was initially turned up and a decision made to start afresh (Globe and Mail [Toronto], 7 December 1988). This strategy apparently helped unblock the situation, for there followed an agreement in principle to bring trade in services under international rules and regulations; however, this agreement was put on hold until agreement was reached on four outstanding issues in the parallel talks on trade in goods (GATT, Focus, No. 59 [January 1989]: 1–2).

The Montreal Agreement, formally adopted in April 1989 in Geneva, was accepted by the developed countries and, grudgingly, by the LDCs. It was agreed that ‘negotiations on the elaboration of a multilateral framework of principles and rules for trade should proceed expeditiously’ (GATT, Focus, 61 [May 1989]: 15). Clearly the details of the agreement remain to be worked out, but a number of principles were agreed upon as a framework for the negotiations. As expected, ‘transparency’ of national laws and regulations concerning the services sector was to be provided for, along with ‘progressive’ liberalisation on the basis of ‘national treatment’. This last meant that foreign service suppliers would enjoy access to national markets under conditions ‘no less favourable’ than those applicable to national or other suppliers, and that this provision would apply to: the cross-border movement of services, consumers, and, crucially, factors of production ‘where such movement is essential to suppliers’ (ibid.). National treatment was to work in conjunction with the traditional GATT principle of non-discrimination or ‘Most-Favoured-Nation’.

There were some general undertakings to look to the needs of the developing countries, helping them with the problems of market access and a vague commitment to assisting them with the development of their service sectors (seen as the sine qua non of effective liberalisation). ‘Particular account’ was to be taken of the poorest LDCs with all their attendant problems (ibid.). More important for the agreement as a whole were the provisions for safeguards and national regulation of service sectors. This had been a controversial area from
the beginning, with the European Community insisting on the respect of national policy objectives and regulatory purposes from the end of 1987 (Goff, 1988: 46-7). This of course included national regulatory frameworks for banking and financial sectors, and by implication the more general macro-economic policy objectives of the negotiating states. The actual agreement, under ‘Safeguards and Exceptions’, specifically mentioned balance of payments reasons as requiring special provisions for national policy intervention. The ‘asymmetries’ in services regulation were formally recognised, as well as their relationship to important national policy objectives such as the ‘pursuance of macro-economic policies’ (GATT, Focus, 61 [May 1989]: 16). An important part of future work would concern the application of the agreed principles to specific sectors, including financial services.

Financial Services were discussed in sectoral group meetings from 18–22 September 1989 (GATT, NUR, 031 [16 October 1989]: 12). Securities and banking services would have to be considered in relation to both cross-border financial flows and establishment/commercial presence. These sectors would prove to be problematic, it was recognised, because of their high degree of regulation and their close relationship to national and international economic management. Some countries clearly wished to maintain the integrity of national systems of regulation, while others stressed that there were many overly-restrictive regulations which could be subjected to multilateral rules and disciplines. The problem areas were identified as rules affecting establishment, the operation of foreign-owned banks and securities houses, and the acquisition of domestic firms. Insurance services likewise presented considerable scope for liberalisation. It was recognised that there had already been substantial progress on the liberalisation of capital flows associated with trade in financial services (ibid.: 13).

Finally, the United States presented the first complete draft legal agreement on trade in services at the negotiating group’s meetings of 23–25 October 1989. All service sectors were to be included, with provisions for market access and right of establishment. The proposal called for a dispute settling mechanism under the auspices of a Committee on Trade in Services. The draft was surprisingly indulgent as far as exceptions to the proposed rules were concerned. Although non-discrimination, transparency and national treatment were the guiding principles, there were provisions for short term balance of payments problems, domestic regulation of services, and general exceptions. Countries would be able to exclude certain services in national schedules, and parties would be able to indicate the special agreements or protocols to which they were privy and that, presumably, might conflict with the general provisions of the eventual agreement. The LDCs expressed concern for the future of their service sectors under the proposal, and India, Singapore, and Korea presented papers of their own on issues of concern to themselves and other
LDCs. The EC sought to elaborate on the notion of non-discrimination as it applied to services. The EC paper envisaged minimum levels of mutual obligations, which would lead in the process of liberalisation to unconditional non-discrimination among signatories (above account from NUR, 032 [21 November 1989]: 12–4).

Clearly, there is considerable political conflict over the internationalisation of markets in financial services. There is much to lose and much to be gained depending on the outcome. No doubt there will be some sort of agreement at the GATT negotiating table, for there is sufficient consensus among the industrialised countries that some sort of regulated progress towards liberalisation is desirable. (The final ministerial meetings for the Uruguay Round are scheduled for 26 November to 8 December of 1990 [GATT, NUR, 030 (3 August 1989): 1].) Even if this prediction proves overly optimistic, less formal co-operation among the advanced countries of the OECD will lead in the same direction. It is to an example of this less formal co-operation in the establishment of international financial markets that this article now turns.

III. The harmonisation of capital adequacy requirements for international banks

The third case in this study concerns an international agreement, negotiated through the Bank for International Settlements (BIS), to determine minimum capital adequacy ratios for banks operating in international markets. In essence, the agreement was a form of international co-operation on the issue of prudential supervision of banking. It represents a clear attempt to initiate international political co-operation where state regulation is almost by definition inadequate, given the internationalised and integrated nature of contemporary financial markets. (See for example OECD [1987b: 27], and also OECD [1985a], on the effects of changes in the banking and financial services sectors on the formulation and implementation of monetary policies, including the supervisory activities of the authorities.) The acceleration of the pace of change in the 1980s clearly provided impetus to banks and supervisory authorities to overhaul legal and regulatory frameworks (OECD, 1987c: 12), an important part of which includes international co-operative agreements.

In this regard, the case of the harmonisation of capital adequacy ratios does not so much relate to political efforts to extend markets into the international domain, but to deal with the political consequences of this extension. The consequences in question are the risks of major financial collapse. This is something which governments, as the putative masters of overextended financial institutions and the customers they serve, can scarcely afford to be associated with. The accelerated integration and interpenetration of financial
services markets, both within and across boundaries, means that there is an increased risk of disturbances in one market segment spilling over into other, formerly distinct, segments (OECD, 1985a: 48; OECD, 1987c: 12-3). These markets, once separated by clear regulatory barriers, are now interlocked by the involvement of large institutions in several financial intermediary functions at once (OECD, 1987c: 12; for a clear exposition of the policy issues, see also OECD, 1985b: 20-4).

It is interesting that the political demands for convergence on the question of capital standards came as much from international banks and other financial institutions as from governments and central bankers themselves. This demonstrates that the politics of financial market regulation is not simply the preserve of arbitrary state authorities. Intensified competition, related to the steady process of internationalisation, innovation, and integration of previously demarcated markets for different kinds of financial services, increased the possibility of volatility and even instability in the markets. Banks, in seeking to compete with other financial institutions encroaching on their traditional territory as clients turned to new forms of financial services, renewed their concern with risk management (OECD, 1987c: 13). This took place against a background of the Third World debt crisis and difficult times for major American credit institutions. According to the OECD, the strategies of banks have been sharply reoriented in response to the new economic and financial environment: ‘The perception of potentially greater risks and uncertainty has contributed to the bringing back into the forefront the issue of bank profitability and capital adequacy’ (OECD, 1987c: 13).

Although the agreement concerns the political management of the consequences of market development, it should be stressed that politics played its part in the internationalisation of financial markets in the first place. This has already been discussed in relation to the rise of the Euromarkets (also see de Cecco, 1986: 381-99), but in more recent times the role of political authorities goes beyond this particular historical development; two such cases have been referred to above. The governments of the major industrialised economies have taken a number of measures to promote economic growth through efficiency and flexibility in financial markets. This includes the reduction of structural rigidities, the fostering of innovation, and increasing the role of market forces in determining outcomes in the sector (OECD, 1987c: 13, and, for a more thorough discussion of policy issues, 63-6). Such ‘reregulation’ has also served to promote the international competitiveness of domestic banking sectors as the liberalisation of trade in financial services increasingly became a reality. These other policy questions cannot, in practical terms, be separated from the issue of prudential supervision which lies behind the capital adequacy agreement (OECD, 1987c: 14).

In financial markets, the issue of prudential supervision has aroused consid-
erable political controversy, which results from the conflicts of interest inherent in the differences between national systems of regulation. Capital adequacy ratios for banks are among the most important aspects of this process. At its most basic, capital adequacy refers essentially to the ratio between a bank’s total assets and its equity capital plus disclosed reserves. Beyond this, however, there is controversy as to whether, and/or how much, supplementary capital such as hidden reserves (for example, real estate) or unrealised capital gains on securities, should constitute part of the ratio used for measuring capital standards. There is also some question as to whether market or regulatory criteria ought to be the primary determinants of the solidity of a bank’s position. As Eiichi Matsumoto, senior managing director at the Bank of Tokyo, put it, ‘capital adequacy is not the only yardstick that can be used to judge soundness. A bank with a small capital base may have no record of loan losses while one with a bigger base has a poor record. How do you judge which is sounder?’ (Globe and Mail, 19 September 1988). Domestic banking operations have long been tightly regulated from this point of view, but international activities have not been so closely supervised. Furthermore, institutions with less stringent capital adequacy standards can undercuts others in credit markets in international competition among banks. Thus there is also an issue of fair competition at stake.

If these are the primary political issues at stake, how did the agreement take shape and what were the principal lines of cleavage within the global banking sector and in corresponding relations among states? The first point to make here is that multilateral collaboration among central bankers is both longstanding and well-developed, as can be ascertained by a cursory examination of the Annual Reports of the Bank for International Settlements (especially the section on ‘Activities of the Bank’). One of the focal points of this collaboration is the Bank for International Settlements in Basle. By way of example, the Group of Ten central bankers meet regularly once a month to discuss exchange rate co-operation; there is a standing committee on the Eurocurrency markets (since 1980); there are Groups of Experts on payments systems, on computer technologies in banking, and on monetary and economic data bank questions; and the European Monetary System’s intervention fund has been organised and monitored from Basle (BIS, 1985: 163–4).

The committee which dealt with the agreement in question is the Committee on Banking Regulations and Supervisory Practices. One of the milestones on the way to the capital standards agreement, concluded by this same committee, was the so-called ‘Basle Concordat’ of 1963, an accord on co-operative supervisory practices with respect to foreign banks’ establishments. (The concordat established practices for the collaborative supervision of such banks between host and parent countries [BIS, 1987b: 181]). This was an important precedent in establishing genuine international arrangements in prudential
supervision. The issue of capital adequacy first gained importance in the early 1980s after a considerable decline in banks’ ratios which was related to interest rate volatility and solvency problems not unconnected with the debt crisis (OECD, 1987b: 17–8; Financial Times, 4 November 1987). The committee’s work on capital ratios was chaired by Peter Cooke, a director of the Bank of England. An Anglo-American proposal of January 1987 (Bank of England, 1987: 85–93) eventually formed the basis of discussions in the committee, and indeed the basis of the eventual agreement itself (Financial Times, 12 November, and 9 December 1987). The first committee discussion document was circulated subsequently in 1987 (BIS, 1987b), and the Cooke Committee’s work initially focused on three elements:

... the construction of a framework of measurement designed to facilitate broad comparisons of capital adequacy standards among different international banks; the monitoring of international efforts to strengthen banks’ capital positions and their provisions against risk; and consideration of new developments and techniques in the field of off-balance-sheet business and their appropriate treatment in assessing capital adequacy (BIS, 1985: 163–4).

It should be noted that by 1984–85 there had already been an agreement on the weighting of bank assets according to risk. This was crucial to the eventual accord on capital standards – without such agreement, there could have been no understanding on how to determine the asset side of capital-asset ratios. The Cooke Committee’s work was then able to focus on defining the capital base and on setting the level of the ratio itself (Financial Times, 11 December 1987).

By the end of the year, agreement had been reached among participating central bankers. Their proposals, which had been issued on 10 December 1987, were to be put to national banking associations for consultation (ibid.). The proposals stated that the capital base for all banks would be eight per cent of total risk assets. This capital base was divided into core capital (equity plus disclosed reserves) which would constitute at least four per cent of the total, and allowable supplementary capital (ibid.). The most controversial aspect of the agreement was the definition of allowable supplementary capital. In brief, these were to be hidden reserves, so long as they had passed through the profit and loss account; reserves arising from the revaluation of fixed assets (real estate); general provisions against loan losses except where there has been a deterioration in relation to particular assets or losses have already been identified; certain debt instruments which bear a close similarity to equity; and subordinated term debt up to an amount equal to 50 per cent of core capital.

As regards timing, from the end of 1990 there was to be an interim minimum
requirement of 7.25 per cent, and the agreement was to be fully phased in by the end of 1992. Of course, included in the proposals were a calculation of risk ratings for banks' assets, and so-called 'off-balance-sheet assets'.

As has been alluded to above, there were considerable differences among the positions of participants in the negotiations, based on underlying conflicts of interest. These conflicts related as much to the notion of a 'level playing field' in international competition as they did to worries about the capacity of national banking systems to conform to new standards (ibid.). Characteristically, the German Bundesbank took the most conservative stance. The German position was essentially that any definition of capital adequacy should only refer to core capital (equity and disclosed reserves), excluding any forms of supplementary capital (Financial Times, 7 November and 11 December 1987, and 12 July 1988). Not surprisingly, German banks would have been better off under such an arrangement. It appears that although West German banks had sufficient equity to conform to the proposed agreement (see below), they had little in the way of debt as far as supplementary capital was concerned (Financial Times, 19 July 1988). The German voice was not particularly heeded at any stage, but even in the final agreement the Bundesbank insisted that a statement be inserted that it wanted to see further work on the idea (ibid.).

At the other extreme was the Japanese position. Japan wanted considerable flexibility in the determination of the capital base, in particular a liberal definition of what could be included as supplementary capital. This is because Japanese banks have operated in international markets with relatively small capital bases (estimated at a total of three per cent: Globe and Mail, 19 September 1988). This has enabled them aggressively to pursue growth in assets while undercutting western banks. The proposals would require the Japanese banks to raise some $50 billion in additional capital, no insignificant amount (Financial Times, 12 May 1988). The Japanese had pressed for the inclusion of up to 70 per cent of average unrealised capital gains included as supplementary capital (as opposed to the 30 per cent favoured by most western bankers: Financial Times, 7 November 1987). Although this bid failed, a compromise of 45 per cent was eventually decided upon (Globe and Mail, 19 September 1988).

Most other countries fell somewhere in the middle. The French wanted to increase the role of residential mortgages in allowable supplementary capital. They also wanted the committee to differentiate among lending to various public institutions, claiming that actual risks vary greatly from one country to another (Financial Times, 22 June 1988). Some minor concessions in this direction were forthcoming (Financial Times, 12 July 1988). France's position had much to do with the fact that many of her banks were large state-owned concerns for which the government would not provide additional capital
(Financial Times, 19 August 1988). There was therefore a desire to limit the extent of necessary adjustment. Canadian banks were well-placed to implement the agreement on a fairly strict basis (Financial Post [Toronto], 12 September 1988), but American banks pushed for concessions in the final stages of negotiations. Only three of the top eleven US banks could meet the proposed requirements (Financial Times, 6 June 1988); the latter were considered likely to put pressure on US money centre banks which concentrate on low-margin wholesale business (Financial Times, 11 December 1987). US bankers insisted that they be allowed to include the proceeds of issues of perpetual preferred shares as part of core capital, and this concession was in fact granted (Financial Times, 12 July 1988).

In the end, the agreement which emerged in July 1988 was not substantially different from the original December 1987 proposals. The German insistence on confining the agreement to core capital, and the Japanese efforts to expand the definition of supplementary capital, went essentially unreognised. The minor concessions did constitute a compromise in several directions, but the accord which was finalised was broadly along the lines of the Anglo-American proposals of early 1987. Central bankers and their putative vassals had taken a bold step towards the international management of the consequences of market development.

This success is likely to lead to other such agreements. Already, securities regulators have begun efforts to promote collaboration with a view to controlling illegal insider securities dealings and fraud (Globe and Mail, 19 November 1988). The BIS has likewise called for an agreement similar to that reached by the Cooke Committee but on the prudential supervision of increasingly internationalised securities markets (Financial Times, 14 June 1988).

Preliminary work on the international co-operative regulation of securities has once again been carried out by the OECD. An important contribution is the organisation's study of extraterritorial information requirements in securities regulation (OECD, 1988). This document, among other issues, laid out the problems for multinational companies floating securities on international markets where information requirements differed widely from country to country. Laws relating to information provision were often conflicting. The study outlined current and prospective international co-operative efforts to facilitate information exchange for regulatory or enforcement purposes (ibid.: 67–76). Several governments indicated their support for the development of multilateral arrangements for the exchange of information for regulatory and enforcement purposes, some even implying a progressive harmonisation of internal regulations (ibid.: 74–6). Co-operation in Europe will of course be greatly accelerated by the 1992 process. Other recommendations included the continuation of the Cooke Committee's work in this area, further development of the Council of Europe's Draft Convention on Insider Trading,
co-operation and harmonisation through the International Organisation of Securities Commissions (IOSCO). Some countries suggested continuing reliance on existing convenants such as bilateral arrangements or the European Convention on Mutual Assistance in Criminal Matters of 1959 (OECD, 1988: 75-6).

In general, there is closer and closer co-operation among the major industrialised economies on the management of the world’s money and on the serious financial imbalances which have evolved among states (Funabashi, 1988). Banks and securities market makers are calling for a better-defined state role in structuring the process of marketisation, the better to take advantage of it without too many attendant risks.

Conclusion

This paper has argued that financial markets, despite the problems of control they present for state managers, are not beyond politics. The cases of the completion of the internal European market of the GATT’s efforts to liberalise trade in financial services point to the role of state authorities in creating and enforcing a framework for market operations across political boundaries. The capital adequacy case points to efforts to deal with the consequences of this extension of markets into the international domain. What all three have demonstrated is that the nature and scope of markets are the subject of ongoing political controversy, and that it is difficult to separate market forces from the political decisions which unleash them. Markets do not have some sort of prior autonomy from political questions: what is at issue is political agreement on the desirability of markets as one solution to the problem of production and distribution of economic resources.

To return to Polanyi,

It is not realised that the gearing of markets into a self-regulating system of tremendous power was not the result of any inherent tendency of markets towards ex crescence, but rather the effect of highly artificial stimulants administered to the body social in order to meet a situation which was created by the no less artificial phenomenon of the machine (Polanyi, 1944: 57).

Today, however, internationalisation has greatly complicated the picture. The emergence of the Euromarkets has made national political control more difficult. Economic interests with political resources are pushing to expand the scope of markets. Political management of this process has spilled over into the domain of inter-state relations, and authorities are looking for ways to in-
institutionalise co-operation. Paradoxically, the consequences of market development must be managed by states with a diminished capacity to do so. The result is a growing need for international co-operative agreements to enhance state policy instruments.

Whatever the changing role of the state in this situation, markets are not managers. Politics fills this gap, and the dominant political interests are tied to market development. The crux of the matter is that in the financial domain states are consistently opting for market solutions to the allocation of resources at the same time as market power increasingly becomes a source of political power.

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Notes

1. For details on the Commission’s estimates of the economic gains from financial market integration, see EC Commission (1988b).
2. Responsibility for financial institutions has since been transferred to the Directorate-General for Competition, one of the most important DGs in the Commission.
3. For an account of the sort of adoption which European financial institutions might undertake with respect to the 1992 process, see SEM (1988), particularly articles by Bendix (67–71), Albrecht (77–91), Davenport on insurance (133–41), Raven on securities markets (173–6). Most of the contributions in the volume are by businessmen and provide useful insight into private sector thinking about the single European market.
4. See for example the OECD studies on trade in services, especially on banking and securities respectively (OECD, 1984; OECD, 1987c). The OECD has also attempted to draw up a conceptual framework covering the issues involved in trade in services (OECD, 1987e). For some time, the OECD has had codes of liberalisation for capital movements and invisible transactions, and a National Treatment Instrument, all of which concern the several aspects of trade in financial services, including the right of establishment. A joint working group of the Committee on Financial Markets and the Committee on Capital Movements and Invisible Transactions is currently updating these arrangements (OECD, 1987c: 49).
5. In fact, negotiations on trade in services were formally separate from the GATT negotiations
on trade in goods. The Group Negotiating Services is part of the Uruguay Round, but in a formal sense it is not part of GATT activities. This was at the insistence of the developing countries. Many LDCs in fact argued that UNCTAD would be a more appropriate forum for the negotiation of the trade-related aspects of services. This was because trade in services is closely connected with such issues, sensitive for the LDCs, as inward investment, technology transfers, and the control of multinational corporations (Mark and Helleiner, 1988: 1–3; 19).

6. Of course, the capital transfers associated with the sale of banking and other financial services, as well as some other sectors where large capital transfers are involved, dwarf the actual amounts of value added gained from service provision itself.

7. Not only issues of financial stability were at stake, but also issues of fair competition on international markets, particularly for Western Banks. Japanese Banks conformed to less stringent minimum capital ratio standards, which gave them an edge in competition. Western Banks wanted an international agreement to curtail this advantage. ('Japanese Banks Pained ...', Globe and Mail, 19 September 1988; 'Sigh of Relief from UK Bankers', Financial Times, 15 December 1987).

8. The problem of risk management must have been considerable indeed, because the imposition of higher capital standards will have the effect of curtailing the competitive position of banks in relation to other financial services companies. Banks which have to augment their capital or reduce their assets to comply with the new regulations will be at a relative disadvantage as far as increasing or maintaining their market share, in relation to other types of institutions, is concerned ('Japanese Banks Pained ...', Globe and Mail, 19 September 1988).

9. The preoccupation with risk management has manifested itself in important but paradoxical ways: the OECD points out that 'risk considerations have been of primary consideration in the creation of new [financial] instruments'. (OECD, 1985b: 16). However, '... the very same changes that have augmented resiliency have also increased the fragility of the financial system in the face of large shocks or changes in confidence... Since national and, indeed, global financial markets are more thoroughly integrated, there is the possibility that a major shock could spread more quickly to a larger number of institutions in a wider range of countries.' (OECD, 1985a: 48).

10. The above summary from 'Steps Towards a Sounder Base...' (Financial Times, 11 December 1987). 'Off-balance-sheet assets' refers to three broad categories of instruments, and they are all generally related to the process of 'securitisation' in international financial markets: 1) acceptances, documentary credits, guarantees and endorsements, standby arrangements, and overdraft facilities (i.e., extensions of credit not initially used but which could be called upon suddenly); 2) medium-term commitments to underwrite clients' securities; 3) other commitments which might constitute risk in the future such as asset sales (selling debt).

11. All along, an unspoken purpose of the entire agreement had been to press the Japanese banks to operate with capital ratios similar to those imposed on Western banks by domestic regulatory authorities ('Banking Without Borders', Financial Times, 19 July 1988). 'The Japanese were willing to go along essentially because the continued expansion of their role in international finance depended upon the acceptability of their practices abroad ('Japan's Role in International Finance', Financial Times, 12 May 1988).
References


