THE END OF AN ERA IN INTERNATIONAL FINANCIAL REGULATION?

A POST-CRISIS RESEARCH AGENDA

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ABSTRACT

The global financial crisis that erupted in the summer of 2007 has made the reform of international prudential financial regulation one of the top priorities of global public policy. Past scholarship has usefully explained the creation and strengthening of international financial standards with reference to three policy arenas: inter-state, domestic, and transnational. Despite the accomplishments of this specialist literature, the recent crisis has revealed a number of limitations in the ways scholars have understood inter-state power relations, the influence of domestic politics, and the significance of transnational actors within international financial regulatory politics. Taken together, developments in each of these three arenas suggest that researchers may also need to be prepared to shift from explaining the strengthening of official international standards to analyzing their weakening in the post-crisis world. The latter task will require scholars to devote more analytical attention to a wider set of international regulatory outcomes, including "informal regulatory convergence", "regulatory fragmentation", and especially "cooperative regulatory decentralization".

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Books Discussed in this Review Essay:

Drezner, Daniel (2007). *All Politics Is Global: Explaining International Regulatory Regimes*. Princeton: Princeton University Press.

Porter, Tony (2005). *Globalization and Finance*. Cambridge, MA, Polity.

Singer, David (2007). *Regulating Capital: Setting Standards for the International Financial System*. Ithaca: Cornell University Press.

Walter, Andrew (2008), *Governing Finance: East Asia's Adoption of International Standards*. Ithaca: Cornell University Press.

The global financial crisis that erupted in the summer of 2007 has prompted politicians to declare the reform of international prudential financial regulation to be one of the top priorities of global public policy. As this issue has come to dominate the agenda of the new G20 leaders summits and other international fora, scholars have scrambled to learn more about the political dynamics associated with this aspect of global economic policymaking. How does past scholarship on the politics of international financial regulation help us to understand the transformations triggered by the financial crisis in this area? Have recent developments revealed any limitations in the pre-crisis literature on this topic? What should be the future research agenda in the wake of the recent global financial crisis?

For over two decades since the publication in 1989 in the pages of *International Organization* of Ethan Kapstein's pioneering work on the Basel Accord, scholarly attention has been focused on the goal of explaining the creation and strengthening of international prudential financial standards in the context of rapidly globalizing financial markets.[3] Theoretically-oriented scholarship on this topic tended to search for explanation and understanding within or across three particular policy arenas: inter-state, domestic, and transnational. Seminal studies emphasized different actors and different political dynamics, as evidenced by four important books published just before the crisis. Daniel Drezner's *All Politics is Global* focuses on the interests of, and exercise of power by, leading states as the primary driver of the creation of international financial standards. David Singer's *Regulating Capital*, and Andrew Walter's *Governing Finance* analyze the interplay at the domestic level between regulators, elected policymakers, financial industry groups, and other societal actors. Tony Porter's *Globalization and Finance* is concerned more with the influence of transgovernmental networks of regulators and transnational non-state actors.

Despite the accomplishments of these books and the other past specialist literature, we argue that there is now a need for some serious rethinking within scholarship on this topic. Theoretical innovation and new empirical research is required to address important limitations

[3] Kapstein 1989. Some of the early literature was surveyed in prominent review essays during the mid-1990s which explored the causes and consequences of the globalization of finance (Cohen 1996, Andrews and Willett 1997).

revealed by the crisis in existing understandings of inter-state power relations, the influence of domestic politics, and the significance of transnational actors within international regulatory politics. Recent developments in all three policy arenas also suggest that researchers need to be prepared to shift from explaining the strengthening of official international standards to analyzing their weakening in the post-crisis world. The latter task will require scholars to explore a wider set of international regulatory outcomes, including "informal regulatory convergence", "regulatory fragmentation", and "cooperative regulatory decentralization". We suggest that a number of post-crisis trends are pointing in direction of the last scenario in particular, and thus encourage future researchers to devote more analytical attention to this regulatory outcome than they have in the past.

Insights from the Pre-Crisis Literature

The construction of international prudential regulatory standards has taken place in a very incremental and piecemeal fashion since the mid-1970s alongside the globalization of financial markets.[4] Early scholarly analyses of this process focused on the banking sector where the development of standards emerged first with the 1975 Basel Concordat concerning banking supervision and the 1988 Basel Accord which set common capital standards for international banks (subsequently updated between 1998-2004 into "Basel II").[5] More recent scholarly literature, such as the four books at the core of this review essay, has moved beyond the

[4] For a description of this process, see for example Davis and Green 2008.

[5] Kapstein 1989, 1994, Oatley and Nabors 1998.

exclusive focus on banking. Singer compares the banking experience with subsequent efforts to create international capital standards in the securities and insurance sectors. Drezner and Walter focus on an even more ambitious initiative: the G7-led "international financial standards project" after the mid-1990s to promote the global adoption of international best-practice standards in those three sectors as well as others such as accounting, auditing, payments systems, and corporate governance.[6] Tony Porter has an even wider focus that includes the creation of international standards relating to institutions such as hedge funds and credit rating agencies as well as new financial products such as derivatives.

Although there is no consensus among these four authors themselves about how to describe debates within existing literature, we believe their work and other past literature on this topic is best classified into three broad categories. Each points to a distinct political arena – inter-state, domestic, and transnational – as the source of the creation and strengthening of international financial standards. Analyses of the *inter-state political context* explain international standards with reference to the exercise of power by dominant states. Drezner's book is the most important recent analysis of this kind. Like Kapstein and most other analysts in this tradition, Drezner identifies relative market size as the key source of international power.[7] While the US held the preeminent financial markets in the world for most of the postwar period, Drezner argues that the European Union has joined it as a second Great Power in recent years

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[6] The G7 also encouraged compliance with IMF standards relating to macroeconomic policy and data transparency, a World Bank standard on insolvency and creditor rights, and the FATF's recommendations relating to regulations to counter money laundering and terrorist finance.

[7] See also Posner 2009, Simmons 2001, Strange 1986.

because of the size of its combined financial space.[8] By controlling access to their all-important financial markets, the US and EU can secure foreign compliance with their preferred international regulatory outcomes.

In the case of the "international financial standards project", Drezner shows how the US and the EU initially used small 'club' settings which they controlled to develop a set of new international standards they favoured. These settings included various international standard setting bodies such as the Basel Committee on Banking Supervision (BCBS) as well as a new institution they created in 1999 – the Financial Stability Forum – to coordinate the process.[9] Once the standards had been consolidated within these narrowly constituted settings, the dominant powers then promoted them globally, using market power as a key weapon. Drezner argues that this power included not just the threat of market closure to non-complying states but also indirect market power involving "communicating/publicizing national compliance with the relevant standards and codes to private sector financial institutions and rating agencies".[10]

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[8] See also Posner 2009.

[9] Before 2009, the BCBS membership consisted entirely of developed countries (the G7 countries plus Belgium, Luxemburg, the Netherlands, Spain, Sweden, and Switzerland). The FSF's country membership was initially restricted to the G7 but was expanded slightly a few months later to include Singapore, Hong Kong, Australia, and Netherlands. Switzerland was then added in 2007. The body also included representatives of the major international standard-setting bodies as well as international bodies such as the IMF, WB, OECD, BIS, the Committee on the Global Financial System, and the European Central Bank.

[10] Drezner 2007, 139.

If the exercise of power by dominant states helps to explain the creation of international standards, what explains the preferences of those states? While some power-centred analysts assume that dominant states are unitary actors pursuing various national interests, others have combined their focus on inter-state politics with an opening of the "black box" to investigate the domestic sources of state preferences. Singer and Walter present the most detailed recent analyses to focus on the *domestic political context* as the primary source of international regulation.[11]

To explain why dominant states favour the creation of international standards in some circumstances and not others, Singer argues that it is necessary to study the preferences of the regulators who have traditionally led these international initiatives. Drawing on a principal-agent framework, Singer describes regulators as bureaucratic agents seeking to preserve their autonomy, prestige, and future job prospects by appeasing domestic legislative bodies (the principal). In order to achieve this goal, regulators attempt to balance the objectives of maintaining financial stability and of preserving the competitiveness of the influential national financial industry. In Singer's model, a dual shock to both stability and competitiveness will create incentives for regulators to turn to international regulatory cooperation as a means to tighten domestic regulation without undermining the competitive position of domestic firms and markets. The latter is particularly sensitive to tighter regulations because of the highly mobile nature of financial activity. By exploring the different patterns of interaction between regulators and their respective legislatures and domestic industries over the past two decades, Singer

[11] Drezner also argues that state preferences are strongly influenced by domestic politics, particularly the resistance of domestic private actors to adjustment costs associated with regulatory coordination.

provides an insightful explanation of diverse patterns of international regulatory coordination among leading states in the banking, securities and insurance sectors.

Singer sees his approach as complementary to inter-state power-oriented analyses. While his analysis accounts for why regulators in “core” states cooperate to create international standards, he argues that regulators secure the cooperation of more “peripheral” states through the flexing of power. By contrast, Walter presents a domestically-oriented analysis that challenges this latter perspective. Through a detailed study of the experiences of Indonesia, South Korea, Malaysia, and Thailand, Walter argues that the degree of their compliance with the G7-led international financial standards project after the mid-1990s was largely a product of domestic politics rather than external pressures. In cases where compliance took place, he suggests that policy choices were usually driven more by domestic pro-reform interests. His more important point, however, is that there was considerable *substantive* non-compliance in many of these countries, particularly with respect to standards relating to corporate governance, accounting, and bank supervision where private sector compliance costs were high and where third party monitoring of compliance was difficult. In the face of strong domestic opposition, a kind of “mock” compliance emerged in these areas characterized by regulatory forbearance at the governmental level, administrative resistance, and private sector non-compliance.

In analyzing compliance debates in these countries, Walter utilizes a broader conception of domestic political processes than Singer. While Singer focuses on the interaction between national regulators, elected policymakers and financial industry groups, Walter explores the role of a wider range of actors who became involved in implementation debates, including pro-reform interests such as taxpayers and non-governmental groups, and anti-reform groups such as non-financial firms and government ministries. Walter also moves beyond Singer’s assumption that private financial sector preferences are uniform (i.e. focused on international competitive concerns) in order to highlight divisions, such as those between weak banks that opposed reforms, and institutional investors and well capitalized financial institutions that supported them. To explain resistance to compliance, Walter also draws more on institutional and structural factors highlighted in comparative politics literature such as the prevalence in East Asian capitalism of family-owned firm structures, bank-based financial systems (which left financial and non-financial interests more closely aligned), and developmental state structures.

A third and final approach to explaining international financial standards has focused on the *transnational political context*, notably the significance of transgovernmental networks and transnational non-state actors that transcend the international/domestic divide. In the most significant analysis of this kind to date, Porter directs our attention to the increasingly dense landscape of international institutions that has been created since the mid-1970s to address the regulation of global finance, such as the various international standard-setting bodies and the FSF. Many analysts who focus on the inter-state and domestic political contexts leave little room for these institutions to influence international regulatory politics independent from the preferences and power of dominant states. Singer, for example, explains his scepticism: "[the institutions] are not constituted by treaty and are not granted agency – legal or otherwise – to act in international affairs. They have skeleton staffs, often consisting of fewer than ten people, and generally exist to facilitate interaction among their members at scheduled intervals throughout the year."[12] From Porter's standpoint, however, these institutions' role in cultivating informal transgovernmental networks of technocratic officials is significant for explaining the emergence of international standards.

[12] Singer 2007, 34; see also p.119.

He embraces a more constructivist perspective than Singer, arguing that the interests of regulators are shaped by their social interactions within these increasingly dense networks.[13] Like earlier work on transnational epistemic communities,[14] he suggests that the highly technical and practical nature of the discussions within the networks foster common knowledge and "shared understandings" among the officials involved, making the exercise of power politics and the pursuit of national interest less pronounced.[15] Because of the esoteric subject matter, discussions within these networks also take place largely outside the scrutiny of domestic politics, with legislative assemblies and governments rarely directly involved in, or aware of, their work.[16] Porter concludes that these transgovernmental networks "cut across the formal structures of states" and "display considerable autonomy from them", thus echoing Anne-Marie Slaughter's broader case that transgovernmental regulatory networks are fostering cooperation by "disaggregating" states.[17]

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[13] For more recent constructivist work on international regulatory politics, see Abdelal 2007, Baker 2006, and Chwieroth 2009.

[14] Kapstein (1992) explored the significance of the concept of transnational epistemic communities for studying bank regulators, but was ultimately cautious about its relevance because of cognitive disagreements at the technical level and because the officials remained embedded within domestic political settings and continued to serve various bureaucratic, national and domestic interests.

[15] Quote from Porter, 2005, 192. See also Porter 2003, Porter 2005, 30, 43.

[16] See also Porter 1993, 2003.

[17] Porter 2005, 43. See Slaughter 2004 who builds on Keohane and Nye 1977.

Porter also highlights the role of transnational non-state actors in international regulatory politics, above all financial industry groups.[18] Like other recent work in the transnationalist vein, he notes that the latter have become increasingly prominent in lobbying public regulators at the international level.[19] Private sector actors have also been significant in directly assuming a regulatory role in international finance through the creation of private standards.[20] The latter have been established by international industry associations (such as the Institute of International Finance), private institutions created specifically for standard-setting (such as the International Accounting Standards Board), and even individual financial exchanges (e.g. the New York Stock Exchange), clearing houses (e.g. CHIPS), and firms (e.g. Lloyd's of London) that set rules on which global markets depend. Unlike state-centric analysts who exclude international standards created by the private sector from their analysis or explain them as the product of the preferences of Great Powers[21], Porter argues that they have become a key feature of international regulatory landscape. Porter also highlights how international public authorities have increasingly endorsed private standards in a number of sectors and have partially delegated the task of risk assessment to large international banks and credit rating agencies within international banking regulation. The intense interaction between transnational networks of regulators and transnational private actors has led some scholars to conclude that international regulatory policymaking has been increasingly

[18] See also Scholte and Schnabel 2002, Germain 2004, Mattli and Woods 2009.

[19] See also Underhill and Zhang 2008.

[20] See also Mügge 2006, Cutler, Haufler, and Porter 1999, Hall and Biersteker 2003, Graz and Nölke 2008.

[21] For the former, see Singer 2007, 8. For the latter, see Drezner 2007, 73-4.

captured by transnational private financial interests.[22] Porter himself agrees that the influence of the transnational financial interests has been growing substantially in recent years, but he cautions that private interests do not always get their way.[23]

How the Crisis Has Challenged Understandings of All Three Contexts

How well have these three broad approaches to the study of international financial regulation stood up to the experience of the recent global financial crisis? In this section, we argue that developments since the start of the crisis have revealed important limitations in the way the literature has analyzed all three political contexts. These limitations, in turn, suggest some important avenues for future theorizing and empirical work within each of the three arenas.

Reconceptualizing Inter-State Power Relations

From an inter-state perspective, the crisis has coincided with, and reinforced, a diffusion of power in global finance, thus challenging analysts to move beyond their past focus on the United States and the European Union as dominant powers in international regulatory politics. In the late 1990s and early 2000s, developing countries were the main targets of the international standards project but they played little role in influencing the agenda of those Great Powers.[24] A decade later, China and other emerging powers within the developing world seized the

[22] Underhill and Zhang 2008, Claessens, Underhill and Zhang 2008.

[23] Porter 2005, 64-6,103-4, 108-110, 115-6, 195.

[24] Walter 2008.

opportunity of the crisis to demand a greater role in discussions about the future of international financial regulation to match their growing weight in global financial markets. Their new influence came less from the hosting of attractive financial markets than from the increasing significance in world markets of their investments and financial institutions. This significance was apparent at various stages of the crisis when cash-strapped US and European institutions pleaded for financial support from investors and financial institutions from many of these "emerging market" countries. The fact that many of these investors and institutions were state-owned (as in the case of sovereign wealth funds, central banks holding large reserves, or state-owned Chinese banks) only reinforced the power of their governments at that moment.[25]

US and European recognition of their dependence on these new centres of wealth in the world economy helped pave the way for a widening of the "clubs" involved in international standard setting. The demands of emerging powers for greater representation were initially met through the creation of G20 leaders summit whose first meeting was focused almost exclusively on international regulatory issues and which immediately took over the role of agenda-setting in this policy area from the G7. With the encouragement of the G20 leaders, the membership of key international standard setting bodies – such as the BCBS - was then quickly widened to incorporate more emerging powers from the developing world. The membership of the FSF was also expanded at the April G20 summit in London to include all G20 members, and this body was transformed into a more robust institution – the Financial Stability Board (FSB).[26]

These developments were important not just because they highlighted that international regulatory politics could no longer be viewed as what Posner calls "Euro-American regulatory

[25] Chin and Helleiner 2008.

[26] Helleiner, Pagliari and Zimmermann 2009. Spain and the European Commission were also added as members of the new FSB at the time of its creation.

condominium"[27]. At a theoretical level, they also revealed the limitation of past scholarship's focus on relative market size as the key source of power in international financial regulatory politics. International regulatory power can stem not just from the hosting of attractive financial markets but also from being the home country for internationally-important investors and institutions. This different kind of "market power" of a number of emerging market countries has, if anything, been augmented by the crisis. Investors and financial institutions from many emerging powers have weathered the crisis better than most American and European firms. Banks located in emerging market countries have also have taken advantage of the massive losses experienced by American and European institutions to climb the charts of the largest banks in the world (the three largest banks in the world in 2009 by market capitalization were Chinese).[28] This has given their home governments growing clout in international regulatory politics. Understanding the significance of this different kind of market power, and how it might be used in the coming years, needs to be a key subject for future research.

The crisis also revealed one further limitation in pre-crisis conceptions of inter-state power. Before the crisis, scholars focused primarily on "power-as-influence"; that is, how the hosting of important markets provided power to shape international rule-making through changing the behavior of other countries. Since the start of the crisis, some flexing of power in international regulatory politics has had a different objective that is closer to what Benjamin Cohen has called "power-as-autonomy". Cohen describes this form of power as the capacity "to exercise policy independence – to act freely, insulated from outside pressure in policy

[27] Posner 2009.

[28] Michael Wines and Edward Wong, "An Unsure China Steps Onto the Global Stage", *New York Times*, 1 April 2009.

formulation and implementation".[29] This form of power has been particularly apparent in the European Union's regulatory response to the crisis. In addition to trying to influence the behaviour of other countries through the G20 international regulatory discussions, European policymakers have acted unilaterally to reduce Europe's dependence on, and vulnerability to, US regulatory practices in a number of areas. They have flexed this "power-as-autonomy" by insisting that international private financial entities operating in Europe be subject to a greater degree of "host country control" by European regulatory authorities than in the past. This attempt to create what some commentators have called a "New Fortress Europe"[30] has been particularly apparent in the derivatives sector where an initiative is underway to force American derivative dealers to clear their EU contracts through a central counterparty located, regulated and supervised in Europe for the first time. In realm of the credit rating agencies, European policymakers have also forced American rating agencies to have their ratings endorsed by a European subsidiary subject to European regulation.

Future theoretical work needs to explore the nature of this "power-as-autonomy" in international regulatory politics in more depth. Its importance has been apparent not just in Europe but also in emerging powers such as China. At the same time that Chinese investments and institutions are becoming more prominent within international markets, the country's domestic financial markets are growing in size and diversity. Chinese domestic markets are hardly able to challenge New York or London in terms of their attractiveness to foreigners yet, not least because the Chinese government limits foreign access to them.[31] Their growth, in other

[29] Cohen 2006, 32.

[30] Véron 2010.

[31] Posner 2010.

words, is not boosting its power-as-influence in international regulatory politics. But it is reinforcing China's power-as-autonomy by lessening the dependence of Chinese firms on US and European markets. This growing ability of China to carve out an independent regulatory path can also be seen in other emerging countries such as Brazil and India whose domestic financial markets are increasing in size and sophistication. Whether officials in these countries take advantage of their rising capacity to adjust domestic regulatory policies without reference to the outside world and to withstand external pressures should be another future research topic. If policymakers do set down that route, their countries' growing power-as-autonomy may turn out to have an even more important impact on the trajectory of international regulatory politics than the power-as-influence gained through their new membership in the "clubs" that set international financial standards.

Changing Domestic Politics in Core States

The crisis also revealed domestic political dynamics in leading advanced industrial countries that are difficult to reconcile with Singer's model. To begin with, it challenged his assumption that "the main actors in international regulatory harmonization are regulatory agencies".[32] The severity of the crisis and the politicization triggered by massive bailouts of financial institutions in the US and Europe put significant domestic pressures on elected policymakers in these core states to become directly involved in international regulatory politics. This was apparent in the way US and European leaders used the G20 leaders process from November 2008 to lay out unprecedentedly detailed priorities and timetables for their own

[32] Singer 2007, 7.

officials and international financial technocrats to follow.[33] This development marked a striking reversal of pre-crisis trends, which Singer had (correctly) summarized in the following way: "the rules of global financial governance are increasingly the creation of international committees of regulators and private actors rather than heads of government acting in concert".[34]

The US Congress and legislative bodies in Europe, especially the European Parliament, also influenced the direction of international regulatory change in a more direct way than simply threatening to curtail the autonomy of regulators (as in Singer's pre-crisis model). The crisis triggered intensive legislative debates in the US and Europe on previously obscure topics such as the regulation of credit default swaps or reforms to accounting standards, generating detailed legislative initiatives which in turn influenced the direction of international regulatory agreements. Members of the US Congress even engaged in diplomatic missions to interact directly with members of the European Parliament on this issue.[35] The role of legislative bodies in shaping the direction of international reform was also enhanced by the ambition of the post-crisis international regulatory reform agenda which left regulators dependent on major legislative action at home to implement commitments reached internationally. This dependence has undermined Singer's assumption drawn from the pre-crisis experience that "regulators who initiate international negotiations over harmonization do not face a ratification requirement and

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[33] Writing before the crisis, Singer (2007, 119) noted: "It is rare for heads of government to engage in direct discussions over the regulation of domestic financial industries".

[34] Singer 2007, 124.

[35] Ruth Sunderland, "US Takes Row Over EU Hedge Funds Directive to Brussels", *The Guardian*, 31 August 2009.

therefore can conduct themselves in a relatively opaque and seemingly apolitical environment".[36] These new direct roles assumed by leaders and legislators from leading countries in international regulatory politics require an in-depth understanding of the preferences of a wider set of public actors – leaders and legislators – towards international regulatory issues, as well as the domestic pressures they face.

The crisis has also challenged the way that many pre-crisis domestic-level analyses understood the role of domestic societal actors in shaping international financial regulation. Like other analysts, Singer highlighted how the range of domestic societal actors engaged in policy debates about international financial regulation was usually much narrower than in international trade or exchange rate politics because of the complexity of financial regulatory policies and their more indirect and less obvious costs and benefits. While Singer noted that financial crises generated domestic political pressure on legislators to act, his model does not explore the specific roles of societal actors beyond the financial industry in much detail. The recent crisis encourages scholars to focus more attention on the role and preferences of a broader range of domestic societal actors in core states. The politicization of financial regulatory issues during and after the crisis triggered the mobilization of corporate actors outside the financial sector as well as citizens' groups, who found in the US Congress and European Parliament new access points to influence US and European positions towards international regulatory reform. We need more detailed knowledge of how the mobilization of these groups beyond the financial industry can influences the direction of state policy towards international regulatory standards indirectly through legislatures, as well as through direct lobbying of regulators and the executive branch.

[36] Singer 2007, 119.

The crisis also highlighted the limitations of models that depict the financial industry in leading powers as a cohesive group in regulatory debates with uniform preferences that stem from international competitive concerns. During the financial crisis, quite sharp divisions emerged among different parts of the private financial sector, divisions which reduced the sector's overall influence. Banks demanded tighter regulation of credit rating agencies against the latter's wishes. Accountants and banks strongly disagreed with each other about the need to reform mark-to-market accounting. Investors and exchanges criticized the reluctance of derivatives dealers and brokers to accept tighter regulation of over-the-counter derivatives. In some cases, these divisions reflected efforts by individual sectors to shift the blame for the crisis and the regulatory burden upon other sectors. In other cases, certain parts of the financial industry recognized material gains they could realize from regulatory tightening in specific areas. The disagreements also reflected different lessons learned from the crisis and distinct judgments about the long-term interests of the financial industry. These developments suggest the need for future theorizing to disaggregate the industry into its constituent parts and to embrace more context-specific analyses of financial industry preferences.

More detailed attention should also be devoted to the entire question of private "capture" of financial regulatory policymaking. Simon Johnson has played a particularly important role in provoking debates on this topic with his argument that the crisis was caused in large part by the "river of deregulatory policies" sponsored by the private financial sector in the US.[37] Johnson has argued that that the financial sector's disproportionate influence over regulatory policies in core states came not just from campaign contributions but also from the prestige and cultural capital it amassed during the boom years as well as from the "revolving doors" between

[37] Johnson 2009.

regulators and financial industry members which allowed the latter to have their preferences internalized in the policymaking process.[38] Britain's top regulator, Lord Turner, has also talked about "regulatory capture through the intellectual zeitgeist" of the dominant belief among regulators in market efficiency during the years leading up to the crisis.[39] Other analysts have highlighted how regulators face particular pressures during financial booms not to rein in excessive financial growth from the financial industry and others who argue that "this time is different". This dynamic suggests the need for more cyclical theories of private influence in which booms encourage deregulation, followed by crises and reregulation.[40]

One final area for future theoretical innovation relating to the domestic context in "core" countries relates to the diffusion of inter-state power described above. Like other prominent pre-crisis analyses of the domestic origins of international financial regulation, Singer models the relationship between independent regulators and their domestic political system drawing on the experience of advanced industrial countries. This approach was understandable when the US and Europe were the principal dominant powers, but it is now more problematic given the growing

[38] Johnson 2009, Singer (2007, 22) also notes that the private financial industry is influential because it is "the source of generous campaign contributions and other forms of political support". Writing before the crisis, Eleni Tsingou (2006) also highlighted how the complexity and dynamism of financial regulatory issues often left regulators dependent on private-sector expertise in order to keep abreast of financial market developments.

[39] Quoted in "Roundtable: How to Tame Global Finance", *Prospect Magazine*, no. 162, 27 August 2009.

[40] Quote from the title of Reinhart and Rogoff 2009. See also Warwick Commission 2009, 30; Sheng 2009, 393. For a discussion of the new literature on capture, see Baker 2010.

influence of policymakers from countries whose domestic political context is often radically different.[41] For instance, the relationship between regulators, politicians, and financial industry groups is quite distinct in China where many of the most internationally active financial institutions are state-owned and regulators remain under more direct control of the executive.

The growing power of countries with quite different domestic political contexts highlights the need for more comparative analyses of the distinct domestic foundations of policies towards international financial regulation. Such analyses should address not just how national institutional arrangements influence state policy towards the design and implementation of international standards (e.g. unitary vs federal politics systems, single regulator vs different regulatory bodies etc.).[42] Equally important are more structural analyses that explore how attitudes towards international regulation are influenced by distinctive "varieties of capitalism".[43] Some recent scholarship has pioneered this approach by showing how the different roles of the financial sector in Anglo-American liberal market economies versus Rhenish coordinated market

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[41] Singer (2007, 32) acknowledges this limitation of his framework: "it is intended to be broadly applicable to any political environment in which a regulator is granted authority by a popularly elected body. Certain regulators are more insulated from political pressures than others, and not all regulators have the same scope or mandate. These sources of variation are deliberately overlooked by the model in exchange for a more general account of regulatory politics in an international context".

[42] Lutz 2004, Mattli and Büthe 2003, Davis and Green 2008, Walter 2008.

[43] For the broader literature on varieties of capitalism, see Hall and Soskice 2001. Drezner (2007, 41-3) also highlights importance of national institutional histories and varieties of capitalism in exploring policy towards international regulatory issues.

economies can help explain disagreements between these countries concerning the role of credit rating agencies within the Basel II negotiations, the adoption of international accounting standards, and the regulation of hedge funds.[44] The global nature of the crisis provides analysts with particularly favourable conditions to advance this kind of comparative research agenda by exploring how this simultaneous shock has generated convergent or conflicting responses in different countries.

In sum, the crisis has reinforced the importance of the overall insight that Singer and others have developed about the centrality of domestic politics for international financial regulatory developments. But it has also revealed new domestic political dynamics in core countries that suggest the need for adjustments to pre-crisis analytical models. Many of our suggestions above are in fact similar to points taken up by Walter in his study of compliance in peripheral countries. As noted above, he analyses a wider range of public and societal actors, identifies the differentiated preferences of financial industry groups, and embraces insights from comparative politics. The crisis has revealed how these approaches are now relevant also to the study of domestic politics within core countries with respect to both the setting of international standards and their domestic implementation.

New Constraints on Transnational Politics

The crisis has also posed some challenges to the kind of transnationalist analytical framework put forward by Porter and others. To begin with, Porter and others in this tradition assume that transgovernmental networks operate quite insulated from their respective domestic

[44] Baker 2006, 86, Wood 2005, Perry and Nölke 2006.

political contexts and from inter-state diplomatic pressures. These networks did demonstrate significant autonomy in the early stages of the crisis; indeed, it is striking how transnational regulatory bodies under the leadership of the FSF took the initial lead in formulating the comprehensive internationally-coordinated regulatory response that was endorsed at the first G20 leaders summit in November 2008.[45] But the ability of internationally-networked technocrats to set the agenda soon became more constrained by the greater activism of the G20 leaders and legislative assemblies such as US Congress and the European Parliament, which started to set detailed priorities and stringent deadlines for technocratic officials to meet.

The very feature of the networks that had been their strength before the crisis – their carefully cultivated autonomy – now became the subject of criticism from politicians who held the unelected international committees of technocratic officials at least partially responsible for the crisis.[46] Faced with newly engaged political leaders and resurgent domestic political pressures, transnational networks of financial officials were increasingly forced to react rather than to lead the international regulatory reform process. This development highlights the need for future research in the transnational tradition to theorize in more depth the ways in which transnational political processes are nested within the domestic and inter-state political contexts.

The crisis has also challenged Porter's assumption that transgovermental networks have a strong capacity to forge consensual technical knowledge. To be sure, this capacity was clearly on display right after the outbreak of the crisis when officials working within the FSF set the international agenda by reaching consensus on a detailed road map to strengthen existing

[45] Helleiner and Pagliari 2009.

[46] As Anne Marie Slaughter (2004) notes, the political vulnerability of transgovernmental networks comes from their uncertain accountability. See also Pauly 1997, Baker 2009.

international standards in various incremental ways. Even more impressive was the fact that by late 2008/early 2009 they had developed a shared commitment to a new macroprudential regulatory philosophy that was aimed at preventing the accumulation of system-wide risk (as opposed to the "microprudential" focus of existing standards on protecting the stability of individual financial institutions, markets and instruments). Since then, however, cracks in the ideational cement began to open, particularly vis-à-vis questions relating to the implementation of macroprudential objectives such as curtailing pro-cyclicality in the financial system or developing differential treatment of "systemically important" institutions. Increasingly strong and public disagreements among financial officials from the leading powers eroded the cohesion, and thus the influence, of transgovernmental expert networks.

These disagreements partly reflected the growing external constraints on their autonomy emanating from domestic and inter-state political contexts. But transgovernmental networks have also experienced challenges from *within*. The severity of the crisis badly shook confidence in the kinds of ideas and forms of knowledge around which technocratic consensus had formed during the preceding years. Walter documents in his book how the East Asian financial crisis of 1997-98 eroded the confidence of policymakers in that region and encouraged them to embrace an Anglo-American model of "regulatory neoliberalism" which came to be considered in international regulatory circles as a superior model.[47] Because the post-2007 crisis originated in US markets and quickly spread to the British financial system, the legitimacy of that model has been undermined and authorities from East Asia, continental Europe and elsewhere have become more assertive in questioning US and UK regulatory practices. In the absence of the old

[47] Walter 2008.

“intellectual compass”[48], the task of creating a focal point around which the reforms of different national regulators can converge has become more difficult. Scholars working in the transnationalist tradition need to research and theorize the politics of consensus formation and knowledge generation within the transgovernmental networks in this new environment.

Future researchers also need to explore whether the difficulties in reaching and maintaining technocratic consensus may be exacerbated by the inclusion of new members from emerging powers within transnational groupings. The latter reform, driven by political imperatives within the inter-state political context, has increased the intellectual diversity represented around the table. In the past, developing country officials often presented quite distinct perspectives on international regulatory issues.[49] These perspectives reflected not just development priorities but also the fact that their countries’ financial systems, regulatory arrangements and traditions were often quite different from those of advanced industrial countries. Are the new members of the “clubs” of international standard setting thus likely to challenge the ideas and knowledge developed by advanced industrial states within these bodies, or will the transgovernmental bodies instead socialize the new members into the worldviews of the existing membership? Similarly, the fact that officials from new member countries such as China are more directly under the influence of their government’s executive branch raises important questions about the capacity of transgovernmental networks to remain insulated from the exercise of power politics and the pursuit of national interest. Is their new membership

[48] Gillian Tett. Lost Through Destructive Creation. *Financial Times*. 3 September 2009.

[49] For example, Porter (2005, 127, 134) notes developing countries’ dissatisfaction within IOSCO of the dominant interpretations of the East Asian crisis during the late 1990s, as well as Chinese criticisms of the Basel Committee in the early 2000s.

further weakening the capacity of transgovernmental networks to remain autonomous? More generally, are emerging states as susceptible to being "disaggregated" in the way that transgovernmental network theory suggests?

A number of post-crisis developments are not easily reconciled with another important trend identified in the transnationalist analytical perspective: its focus on the growing power of transnational private interests in international regulatory politics. Faced with a crisis of such enormous scale, politicians seized back much of the regulatory authority they had delegated to private actors. Under attack for its unclear accountability, the poster child for "private authority" in international regulatory politics – the IASB - accepted public oversight of its activities for the first time in early 2009. G20 policymakers also committed to extending greater public control over those sectors where international regulatory responsibility had been delegated to the self-regulatory initiatives by transnational private actors before the crisis, such as derivatives traded over-the-counter, hedge funds, and credit risk management by banks. In addition, they agreed to assume a greater role in monitoring and enforcing compliance in areas where these activities had previously been assigned to voluntary efforts, as in the case of credit rating agencies. Lobby groups representing international financial industry have opposed, but failed to stop, a number of these international regulatory reforms, as well as others such as the introduction of international standards on compensation.

The crisis has thus revealed how the power of transnational private actors is more contingent that some of the pre-crisis literature suggested.[50] Before the crisis, the close relations between transgovernmental networks and the transnational financial industry drove many of the

[50] For an important exception, see Pauly 2003.

pre-crisis international regulatory trends.[51] According to Eleni Tsingou, these elite officials and industry actors increasingly constituted a cohesive "transnational policy community" transcending the distinction between public and private, and dominating international financial regulatory politics.[52] As the crisis shifted the political action more to the domestic and inter-state contexts, this community became, in Tsingou's words, "under stress" and transnational private sector groups found it less easy to capture the international regulatory agenda.[53]

Moreover, while the pre-crisis literature often depicted transnational private financial interests in monolithic terms, this crisis has revealed the emergence of sharp divisions among transnational financial industry. Some fault lines reflected the same kinds of conflicts noted above at the domestic level. But intra-industry conflicts at the transnational level were exacerbated by developments in the inter-state and domestic political context. In the aftermath of the bailouts, policymakers put pressures on their national banks to strengthen their ties and redirect the provision of credit towards their home economy. The heightened awareness that global banks are global in life, but national in death (as the governor of the Bank of England Mervyn King put it) has complicated the efforts to forge a coherent transnational private sector voice.[54] The ability of transnational private groups to remain a coherent transnational political force may also be weakened by the growing status of financial firms from emerging powers, especially China. While state-owned Chinese banks are now members of the IIF, the ambiguity

[51] Underhill and Zhang 2008.

[52] Tsingou 2006.

[53] Tsingou 2009.

[54] For King, see Financial Services Authority 2009, 36.

of their status may inform their perspectives on international regulatory issues and align them more with those of public authorities in their home country.

All of this is not to suggest that international private financial interests have lacked influence in post-crisis international regulatory politics. As memories of the crisis have begun to fade, transnational private sector lobbies have also become bolder and more successful in their efforts to slow down and dilute many international initiatives to tighten regulation, often by exploiting policymakers' concerns about international competitiveness issues, and by highlighting the costs that regulation could impose upon the broader economy by stifling the recovery from the crisis. From the perspective of a number of observers, the enduring power of transnational private interests has been apparent in the fact that most international regulatory reforms today have been incremental rather than radical, even in the face of the worse global financial upheaval since the 1930s.[55] These developments have kept the debates about private "capture" politically salient at both the transnational and national levels, and they highlight once again the need for scholars to devote more serious theoretical attention to this issue.

Insights from a More Integrative Approach: Towards a Weakening of International Standards?

These various limitations in the predominant understandings of the inter-state, domestic and transnational political contexts revealed by the crisis should encourage scholars to rethink the analytical toolkits they had developed prior to the crisis and adjust them to these new circumstances. At the same time, more effort should be devoted to the task of integrating insights

[55] Tsingou 2009.

from developments in all three of these political contexts. This integrative approach is fundamentally important for scholars inquiring about the future trajectory of international financial regulation in the post-crisis world. For over two decades, scholarship concerning the politics of international prudential regulation has been focused on explaining the creation and strengthening of international standards. When we examine post-crisis developments within the inter-state, domestic and transnational political arenas in an integrated way, the durability of this trend of ever-strengthening official international standards is called into question.

One reason that the design of strong harmonized official international standards is likely to become more difficult in the coming years has to do with the diffusion of inter-state power in international regulatory affairs. The fact that new powers have now been included within the most important international regulatory bodies is likely to make consensus harder to reach.[56] In addition to increasing the number of veto players, the diffusion of power may increase competition amongst Great Powers, and generate more possible focal points around which convergence could take place. The enhanced "power-as-autonomy" of many emerging powers could also reinforce these trends, as states acquire greater capacity to disregard external pressures to adopt international standards.

Some domestic-level developments also point to a possible weakening of international standards after the crisis. To be sure, faced with mounting domestic pressure to tighten regulation, regulators in the core countries have faced strong incentives to coordinate their actions for the reason Singer suggests: unilateral action by any one regulator could undermine the competitiveness of their country's domestic firms and markets. International standards also help regulators to minimize the risks of negative externalities arising from poorly regulated

[56] Levinson 2010, 85. See also Drezner 2007.

jurisdictions abroad. But the wider domestic politicization of financial regulation triggered by the crisis has also complicated the task of arriving at international consensus as legislators, leaders, and a wider array of domestic societal groups have become more involved in regulatory debates.

The greater diversity in domestic political arrangements represented at the table of international standard-setting is also increasing the heterogeneity in regulators' preferences in ways that may hinder their capacity to commit to detailed harmonized international standards.[57] In addition, as the global shock is refracted through the imperatives of a greater number of "varieties of capitalism", the crisis may lead to increasingly uneven levels of implementation of international regulatory initiatives as well as unilateral moves by national authorities to preserve their distinctive domestic arrangements. The weakening of official international standards may be reinforced as regulators are prompted by the changed domestic political dynamics within the core powers to reduce their vulnerability to sources of risks outside their oversight. Support for greater "host country" regulation of international firms has been strengthened by episodes such as the failure of Icelandic authorities to regulate their banks abroad and the role of domestic authorities in the massive bailouts.[58] Greater reliance on host country rules may have the effect of forcing large international financial institutions to move in the direction of segmenting their business into a collection of separately capitalized national subsidiaries that are subject to distinct sets of rules.[59] In such a world, countries would have greater freedom to implement the national standards that they preferred.

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[57] Persaud 2010, 638.

[58] Persaud 2010, 642.

[59] Martin Wolf. New Dynamics. *Financial Times*, 6 November 2009, Pauly 2009, Persaud 2010.

These trends within the domestic and inter-state political arenas may be reinforced by the weakening of the autonomy of transgovernmental technocratic networks. As discussed above, officials within these networks may also encounter greater difficulties reaching consensus as the networks expand in size and heterogeneity. Furthermore, in the one area where a strong post-crisis consensus has emerged – macroprudential regulation – many of the new policy goals may push regulators away from detailed international harmonization. International initiatives to apply stricter regulation over systemically important institutions, for example, have quickly concluded that many international standards in this area are likely only at a very general level of principles because "a high degree of judgment and flexibility to reflect national and conjunctural circumstances will inevitably be involved in the assessments" of which institutions fit in this category.[60] Other aspects of the macroprudential regulatory agenda may also encourage greater segmentation of global financial business along national lines. Initiatives to require systemically important financial institutions to establish "living wills", for example, will likely to have the effect of forcing these firms to "ring fence" their global business in this way. The same consequence may flow from efforts to introduce counter-cyclical capital charges for banks. Because credit cycles vary by country, the BIS has noted that counter-cyclical capital charges "must be adjusted separately for each geographical portfolio held by an institution operating across national boundaries".[61] For this reason, a number of analysts have concluded that counter-cyclical charges would most effectively be implemented simply on a host country basis.[62] The

[60] FSB, IMF, BIS 2009, 4.

[61] BIS 2009, 132.

[62] See for example Brunnermeier et al, 2009.

macroprudential agenda may thus reinforce the other trends that are pushing in the direction of a more "unlevel playing field" in the international regulatory realm.[63]

Of course, a countervailing force may be the creation of the new FSB which is designed to strengthen the capacity of transgovernmental networks of regulators to coordinate and implement international standards. The FSB has been given a more robust structure than the FSF, including an enlarged secretariat, a full-time Secretary General, a permanent Steering Committee, and some standing committees. It also has an official charter which sets out obligations on members to undergo peer reviews and periodic assessments of the implementation of international financial standards by the IMF and World Bank. Some, such as US Treasury Secretary Timothy Geithner, have even described the new organization in very ambitious terms as "in effect, a fourth pillar" of world economic architecture alongside the IMF, World Bank, and WTO.[64] Whether this institution lives up to these expectations in the face of the pressures outlined earlier must be a central subject for research in this area.

One other countervailing force is likely to be the lobbying of transnational private interests who favor the international harmonization of standards. During the crisis, they have often opposed unilateral initiatives and other moves towards regulatory divergence since these measures could force them to split their global operations along national (or regional) lines and create inconsistent regulatory frameworks and duplicative requirements in different countries. As noted above, however, their influence and coherence may be weakened in the post-crisis world.

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[63] Warwick Commission 2009. See also Gillian Tett. Brazil Clips Wings of Banks Adept at Capital Flight. *Financial Times*, 26 November 2009.

[64] US Treasury 2009.

It is obviously very difficult to anticipate how these various trends in the inter-state, domestic and transnational political contexts will play out (see Figure 1 for a summary). But they highlight clearly that scholars need to take more seriously at least the *possibility* of a weakening of official international standards in the coming years. The dominant focus of past literature on explaining the creation and strengthening of international standards made sense given "real world" trends before the crisis. Scholars of international financial regulation must now be prepared to focus on a wider set of possible international regulatory outcomes.

FIGURE 1: DETERMINANTS OF INTERNATIONAL REGULATORY CHANGE, PRE AND POST-CRISIS				
	Determinant of international regulatory change	**Pre-crisis**	**Post-crisis**	**Anticipated impact on international standards** (+ strengthening, - weakening)
Inter-state context	Degree of power concentration	Concentrated (“Euro-American regulatory condominium”)	More multipolar with emerging powers from developing world	-
	Typology of power	Power-as-influence from market size	•Power-as-influence from market size as well as growing significance of emerging countries’ firms and investments in world markets •Power-as-autonomy from growing market size and diversity	-
Domestic context in core countries	Regulators’ preferences	Balancing stability and competitiveness of domestic firms	Stronger domestic pressures to “fix” domestic regulation and reduce vulnerability to external risk	+/-
	Interest groups lobbying regulators and policymakers	Mainly financial industry	Financial industry + wider number of interest groups	-
	Role of elected policymakers (leaders, parliaments)	Indirect	Direct	-
	Varieties of capitalism	Liberal (dominant) and coordinated market economies (subordinate)	Greater diversity of varieties of capitalism	-
Transnational context	Autonomy of transgovernmental networks of regulators	High	Lower (pressures from elected leaders and legislatures)	-
	Veto players in transgovernmental networks of regulators	Low (narrow membership)	Higher (inclusion of new members)	-
	Heterogeneity of preferences	Low (like-minded nature of transgovernmental networks of regulators)	Higher (new members have different regulatory models)	-
	Focus of transgovernmental networks	Microprudential focus	Micro and macroprudential focus	+/-
	Institutional coordination among transgovernmental networks of regulators	Medium (FSF, standard-setting bodies)	Higher (creation of FSB)	+
	Influence of transnational non-state actors	Strong (Transnational regulatory capture/transnational policy community)	Weaker	-

New Outcomes to Explain

What kind of international regulatory outcomes would need to be explained in a world of weakening official international standards? A number of the books reviewed here note that international market pressures and ideational diffusion may still generate informal regulatory convergence even in the absence of deliberate intergovernmental efforts to create international standards.[65] Governments may be tempted to maintain a level regulatory playing field vis-à-vis other states in order to bolster the confidence of investors, to prevent mobile financial firms from shifting their activities to more attractive regulatory environments abroad, or to conform to what is regarded by markets as "best practices". Porter also shows how the self-regulatory activities of private actors with transnational reach may lead to a convergence of practices despite the failure of international cooperation among national regulatory authorities.

But are these mechanisms of informal convergence strong enough to counteract the centrifugal forces described above which are pushing policymakers towards charting independent regulatory paths? Walter argues that the power of transnational market pressures to promote convergence varies across different sectors and should not be overstated.[66] The possibility that informal regulatory convergence could be driven by a process of ideational diffusion also seems much less likely in a world where the credibility of the pre-crisis regulatory model has been weakened and there is much less consensus on optimal regulatory models. Finally, we have suggested that transnational private actors are weaker and more divided now

[65] See also Simmons and Elkins 2004, Simmons 2001, Cerny 1994.

[66] Walter 2008.

than in the pre-crisis period, thus making it more difficult that they will be able to create a united front capable of filling growing gaps that may be left by governments in international standard-setting through private international rule-making.[67].

If transnational market pressures, ideational diffusion, and private rule-making capacity are less influential, then a world of weakening official international standards is more likely to be associated with regulatory divergence. The implications of greater regulatory divergence, and the ways it can be governed, represent an important avenue for theoretical inquiry that has not been adequately explored by the pre-crisis scholarship. The latter was inclined to equate regulatory divergence with an unraveling of international cooperation. For instance, Drezner highlights how the absence of strong cooperation among Great Powers may generate either "rival standards" or "sham standards". Singer provides examples of the former, while the latter is exemplified by Walter's focus on East Asian "mock compliance" with the international standards project.

These analyses are important but a move away from strong official international standards need not necessarily be associated with the absence of intergovernmental cooperation. What about situations in which effective international cooperation is explicitly designed to facilitate the co-existence of divergent national or regional standards? Drezner comes closest to acknowledging this possibility when he states that regulatory cooperation does not automatically imply policy convergence but could involve "the mutual recognition of other national standards".[68] In the post-crisis era, scholars need to give more serious attention to this possible outcome, particularly because it has become the subject of major debate within international policymaking circles.

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67 Mügge 2006.

68 Drezner 2007, 11.

In a widely discussed March 2009 article in *The Economist*, Dani Rodrik argued forcefully for a new model of international regulatory cooperation along these lines.[69] His case rested on a strong critique of the international standards project of recent years. In his view, the drive to create "one size fits all" global standards overlooked the fact that "desirable forms of financial regulation differ across countries depending on their preferences and levels of development". It was also imprudent because policymakers could easily "end up converging on the wrong set of regulations", a possibility that the crisis appeared to have revealed very starkly.[70] Moreover, he questioned whether it was really politically realistic to expect that leading countries, such as the US, would agree to "surrender significant sovereignty" in international standard-setting processes.

In place of strong harmonized international standards, Rodrik advocated a "Plan B for global finance" which would place the choice and responsibility for financial regulation and supervision much more squarely at the national level (or perhaps regional level, in a case such as Europe). Global financial firms would be supervised by host country authorities and abide by host country regulations relating to such issues as leverage and capital standards. Rodrik acknowledged that the international financial order would thus become somewhat more segmented, but he argued that "an architecture that respects national diversity does more to advance the cause of globalisation than ambitious plans that assume it away". This move away from strong international standards would not be a world without international cooperation. To prevent "adverse spillovers", he suggested that countries would need to agree to "an international financial charter with limited aims, focused on financial transparency, consultation among

[69] Rodrik 2009. The following quotes are all from this article.

[70] See also Levinson 2010.

national regulators, and limits on jurisdictions (such as offshore centres) that export financial instability." Regulatory arbitrage, in particular, would be dealt with by giving governments the "right to intervene in cross-border financial transactions—but only in so far as the intent is to prevent competition from less-strict jurisdictions from undermining domestic regulations".[71]

The case for this more decentralized international regulatory order has been developed further by the Warwick Commission on International Financial Reform.[72] In addition to echoing Rodrik's arguments against detailed global standards, the Commission added the case that nationally-distinctive host country regulations would greatly simplify the implementation of the new "macroprudential" counter-cyclical regulations that the G20 and FSB have endorsed,[73] and also enable developing countries to better tackle distinctive risks associated with currency mismatches or pro-cyclical capital flows. The Commission also noted that countries would be better insulated from the collapse of a parent bank abroad – the "Iceland problem" - if international banks were forced to establish subsidiaries regulated by host governments.

Like Rodrik, the Commission argued that host country rules would need to be coordinated internationally at the level of common broad principles in order to address competitive pressures and externalities stemming from poor regulation abroad and to prevent the use of host country rules for protectionist purposes. International assistance would also be needed to boost the capacity of smaller and/or poorer countries that may lack sufficient capacity to implement effective host country regulation. Equally important would be the task of strengthening the capacity of all countries to regulate at the national level through cooperative research, early

[71] All quotes are from Rodrik 2009.

[72] Warwick Commission 2009. See also Persaud 2010.

[73] See also Brunnermeier et al. 2009.

warning systems for global risks, and extensive information sharing (relating to market developments, activities of large firms, regulatory initiatives abroad). The Commission suggested that the new FSB might be well positioned to support these various cooperative tasks.

One other blueprint for a model of international cooperation designed to allow a more decentralized international regulatory order has come from Barry Eichengreen. Unlike the proposals of Rodrik and the Warwick Commission, Eichengreen's plan would not rely on greater use of host country regulation. Instead, he suggests that an international organization "would establish principles for prudential supervision" but in a manner that allowed for national diversity. These principles would not "prescribe the structure of regulation in detail" and members would be able "to tailor supervision and regulation to the particularities of their financial markets".[74] To prevent the "destructive spillovers of poor regulation", Eichengreen suggests that countries could block access to their financial markets to institutions that were chartered in countries that did not meet the broad principles. Judgments about this could be made by "an independent body of experts, not unlike the WTO's Dispute Settlement panels".[75] Eichengreen notes that an advantage of this proposal would be that private institutions seeking to operate abroad would have a clear incentive to lobby for tighter regulations at home. To perform these various tasks, Eichengreen proposes that the creation of a new "World Financial Organization" (WFO) but the FSB might also be well suited to assume these roles.

[74] Quotes from Eichengreen 2009, 18, 19. Other critics of detailed harmonized international rules who favour more principles-based international standards which allow for more national policy space include Bryant 2003, Tarullo 2008, 223, 265, 282-4, Sheng 2009, 361.

[75] Quotes from Eichengreen 2008, 26.

These proposals highlight that effective international cooperation need not always be associated with creation and strengthening of strong harmonized international standards. We can think instead of a wider range of international regulatory outcomes, as outlined below in Figure 2. Under this framework, four possible outcomes exist, according to variations in both the level of inter-state cooperation and the degree of regulatory convergence. As noted above, existing scholarship has highlighted how regulatory convergence can be a product of not just inter-state cooperation (the upper left-hand quadrant) but also international market and ideational pressures or the self-regulatory initiatives of the private sector (the lower left-hand quadrant). In our view, however, the issue that deserves more attention from future scholarship concerns the options on the right hand side of the table. If we are heading for a world of greater regulatory divergence, the key question whether this take place within a framework of strong inter-state cooperation or not. The latter would result in a more fragmented international regulatory order of the kind that Drezner's sham or rival standards describe (the bottom right-hand quadrant).[76] The former would represent what we might call a scenario of "cooperative decentralization" advocated by Rodrik's Plan B, the Warwick Commission, or Eichengreen's WFO (the top right-hand quadrant).

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[76] It is also worth noting that a fragmented regulatory order need not be seen only in a negative light. Joseph Stiglitz has suggested that this bottom right-hand quadrant may be an outcome worth striving for. If meaningful international regulatory cooperation cannot be achieved in the post-crisis era, he argues that a unilateral strengthening of domestic regulation may be a "second best" policy but it is "far better than the third-best alternative of delayed and ineffective regulation"; Joseph Stiglitz, Watchdogs Need Not Bark Together. *Financial Times*. 9 February 2010.

FIGURE 2: TYPOLOGY OF INTERNATIONAL REGULATORY OUTCOMES		
	Regulatory Convergence	**Regulatory divergence**
Inter-state Cooperation	Strong international standards	Cooperative decentralization
Absence of Inter-state Cooperation	Informal convergence	Fragmentation

Theorizing Regulatory Divergence

Under what political conditions is the scenario of cooperative decentralization likely to prevail over fragmentation? The answer will depend partly on the capacity of international regulatory bodies to facilitate that cooperation in the face of strong centrifugal political pressures. At first sight, these institutional capacities seem to be limited by the lack of a strong international organization with the power to monitor and enforce compliance among its members. The existing patchwork of transgovernmental regulatory bodies remains constrained by its loose network-based structures and weak enforcement mechanisms as well as the increasingly diverse membership of these bodies. The creation of the FSB has strengthened the structure of transgovernmental cooperation, but it has little formal power and acts more as a "network of networks" than a substantial international institution along the lines of IMF, World Bank or the WTO.[77]

It is important to recall, however, that the institutional form which best facilitates international regulatory cooperation is not independent from the "content" of the cooperation being sought. The kinds of international cooperation required to sustain a scenario of cooperative

[77] Porter (2007, 124) used the phrase "network of networks" to describe the FSF.

decentralization are different from those supporting the creation of the strong harmonized international standards. While some assume that more international cooperation is inherently useful, advocates of cooperative decentralization highlight the benefits of scaling back the ambitious forms of cooperation that were embodied in the efforts to build strong official international standards. As Rodrik puts it, "the world economy will be far more stable and prosperous with a thin veneer of international co-operation superimposed on strong national regulations than with attempts to construct a bold global regulatory and supervisory framework".[78] According to the blueprints for cooperative decentralization outlined above, this "thin veneer of international cooperation" would be centered around the development and promotion of broad principles-based international regulatory standards as well as activities such as information-sharing, research collaboration, international early warning systems, and capacity building. Network-based cooperation might suffice to sustain these more limited tasks since this "new internationalism" would not rely so heavily on detailed international commitments or enforcement [79] Indeed, networks may even have some advantages since scholars have often identified the facilitation of these kinds of activities as among the main strengths of this form of governance.

One other cooperative activity outlined by some advocates of "cooperative decentralization" involves the process of penalizing jurisdictions that do not abide by minimum international principles. Under Eichengreen's proposal, an international institution would authorize the use of sanctions against such jurisdictions. Interestingly, the FSB has already moved quickly to assume this role, establishing a set of procedures that will allow its members to

[78] Rodrik 2009. See also Levinson 2010.

[79] Quote from Persaud 2010, 643.

identify jurisdictions that are not complying with some international principles relating to cooperation and information exchange vis-à-vis the regulation and supervision of banks, securities, and insurance. Among many possible penalties for non-compliance is included the blocking of access to the FSB members' financial markets. This initiative signals a willingness of FSB members to see the organization combine "soft" networked governance with the use of "hard" power or "hierarchy".

While the FSB members are willing to enforce compliance collectively vis-à-vis small outsiders, scholars have noted that networked governance is less well suited to punish members of the network itself. As Mette Eilstrup-Sangiovanni puts it, networks are defined by their lack of a "legitimate organizational authority to resolve disputes among actors".[80] The FSB reveals this tendency as well. Its members have chosen to assign the FSB plenary the role of identifying non-complying jurisdictions, rather than the kind of WTO-like dispute settlement panel that Eichengreen proposes. Because the plenary is governed by a consensus of all members, it is unlikely that sanctions would ever be applied against FSB member country. For the "insiders", the pressure to comply will stem instead from softer forms of influence such as the new peer review process and periodic assessments of compliance with international standards by the IMF and World Bank. If those mechanisms prove insufficient to protect against poor regulation from other members, countries may be tempted to resort more to stronger host country regulation, either unilaterally (reinforcing the fragmentation outcome) or in a coordinated way, as suggested by Rodrik and others.[81]

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78 Eilstrup-Sangiovanni 2009, 199.

[81] See also Levinson 2010.

Theorists thus need to consider seriously the hypothesis that the major international governance innovations emerging from the crisis are in fact pointing in the direction of the kinds of institutional capacities required to sustain a scenario of cooperative decentralization. While the crisis has not led to the emergence of a "World Financial Organization", the creation of the FSB and the upgrade of the G20 grouping to the leaders' level have strengthened the kind of network-based forms of governance – combined with the collective use of hard power vis-à-vis outsiders - which may in fact be suited to support the kinds of international cooperation necessary for that scenario.

In addition to these institutional capacity issues, the unfolding of a scenario of cooperative decentralization - as opposed to one of fragmentation - will depend also on the incentives that national regulators and policymakers face to cooperate. We have argued above that the financial crisis has created new pressures and dynamics pushing these officials in the direction of carving out greater degrees of national (or regional) regulatory autonomy. At the same time, the incentives to cooperate remain strong because of the high level of global economic integration. Despite the deepest financial crisis in over six decades, there are very few signs of a collapse of global economic interdependence and the emergence of rival closed economic blocs comparable to the 1930s. In this context, national officials are still drawn to international cooperation in order to address the risks of both competitive problems and negative externalities that can arise from poor financial regulatory practices in other countries. Even if they find it difficult to create strong international standards for the reasons noted above, policymakers will still be tempted to mitigate these problems through looser forms of cooperation such as principles-based international standards, information-sharing, research collaboration, international early warning systems, and capacity building. As outlined above, enduring global financial interdependence also creates strong internationally-oriented private sector constituencies at the domestic and transnational level which pressure policymakers to support cooperative arrangements over the fragmentation scenario because of fears that the latter could encourage protectionism and complicate their cross-border operations.

Future scholarship needs to be alert to the possibility that policymakers may increasingly embrace an international regulatory order centered around cooperative decentralization as a means of reconciling these competing incentives for greater national (or regional) autonomy within the context of still-integrated global markets. This reconciliation would share some similarities with the "embedded liberal" compromise of Bretton Woods where policymakers sought to construct a multilateral open world economy that was compatible with the desire for national policy autonomy.[82] While the Bretton Woods architects pursued this goal in the context of rebuilding a world economy after the collapse of the 1930s, today's advocates of greater decentralization are responding to pressures for greater national policy space within an already-existing global economy. Ruggie described how the initial embedded liberal compromise was a product of US power and a shared transnational social purpose of embedded liberal values that combined during the unique moment of the Bretton Woods negotiations of the early 1940s. In the current period, a movement from the top left hand quadrant of strong international standards to the top right hand quadrant of cooperative decentralization would likely be a more incremental and experimental process driven by efforts of policymakers, working within dense transgovernmental networks, to reconcile the competing incentives outlined above.

In exploring the likelihood of this scenario vis-à-vis fragmentation, scholars also need to be prepared for one additional possibility: variance in outcomes across different financial sectors.

[82] Ruggie 1982.

The strength of transgovernmental networks is not uniform across these sectors. The incentives pushing towards cooperative outcomes are not either. The intensity of cross-border competitive pressures, for example, is uneven from one part of the financial industry to another. Inadequate foreign regulatory practices also do not generate the same levels of negative externalities in all sectors. The cohesion and influence of transnational private financial groups is also not uniform across each segments of the financial industry. These differences helped to explain why the pre-crisis trend towards the strengthening of international standards varied across financial sectors. In a similar manner, they may influence whether a scenario of cooperative decentralization, rather than fragmentation, unfolds if international standards begin to weaken.

Conclusion

The study of the politics of international prudential regulation is suddenly attracting more scholarly attention as policymakers prioritize international financial regulatory reforms in response to the recent global financial crisis. Fortunately, post-crisis scholarship on this topic need not start at square one; there is rich specialist literature over the past two decades analyzing the creation and strengthening of international prudential standards. Our analysis suggests that the crisis has revealed a number of limitations in the ways scholars have understood each of the three political arenas influencing international prudential regulation. Those concentrating on the inter-state political arena need to address a power shift in finance revealed by the crisis and to conceptualize power in international regulatory politics more broadly than just in terms of "market size" and "power-as-influence". The literature examining the domestic political sources of international financial regulation in "core states" should devote more attention to a wider set of public and societal actors, the complexity of the role of the private financial industry, and comparative perspectives. Transnationalist scholarship must recognize the limits of the autonomy and coherence of transgovernmental technocratic networks as well as of the power of private transnational interests.

Taken together, the developments revealed by the crisis within each of the three political contexts suggest that the crisis could represent a potential turning point for the initiatives that have been underway since the 1970s to build and strengthen international prudential standards. Supporters of these initiatives have hoped that they would make the globalized financial order increasingly shockproof. The post-2007 crisis dashed those hopes spectacularly, and it may, for the reasons outlined in the previous section, represent the highwater mark of the international standards project. If this turns out to be the case, the crisis would signal the end of an era in both the politics of international financial regulation as well as scholarship on this topic. Scholars would need to begin analyzing not the strengthening of international standards but their weakening in the coming years. Future theorizing would need to focus on the different international regulatory outcomes of informal convergence, fragmentation, and cooperative decentralization. In our view, the last scenario is particularly deserving of more analytical attention not just because it has been so neglected in the past but also because a number of post-crisis trends point in its direction.

Addressing these various issues will require scholars of the politics of international prudential regulation to embrace a wider research agenda than they have in the past. At the same time, they will also need to do a better job at bringing out the broader implications of their subject for a wider non-specialist audience. Before the crisis, the politics of international prudential financial regulation had attracted the attention of only a narrow group of specialists who were willing to immerse themselves in its highly technical details and often obscure initiatives. The crisis has revealed dramatically the enormous consequences that international prudential regulation has for the global economy as a whole. It has also highlighted the importance that the *politics* of international prudential regulation has had in influencing both the regulatory shortcomings that led to the crisis and the way out of the crisis. As the scholarly attention for this subject has grown significantly, it will be important for specialists of this topic to engage in more active dialogue with a broader range of scholars beyond their narrow subfield, including economists, specialists in comparative political economy, and IPE scholars who study other sectors of the world economy.

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