Introduction

The 1970s was a troubled, even crisis decade for the advanced industrialized countries of the Western world. Growth rates fell quite substantially from their preceding post-Second World War plateau, with both unemployment and inflation increasing rapidly. This led to the identification of a qualitatively new economic phenomenon, **stagflation**, in which advanced industrialized economies seemed to be powerless to re-energize their economies but paid the price for attempting to do so in the form of accelerating prices.

The eventual response to the conditions of the 1970s was a turn against government intervention in the economy. National controls on the free movement of capital, money, goods, services, and people were progressively eased, and the language of 'markets' began to dominate the way in which politicians talked about their economic priorities. International institutions were also given extra authority to deprive markets of the overwhelmingly national character that they had displayed in the 1970s, and to superimpose an increasingly global character in its place.

Yet just how prevalent is the trend towards genuine economic globalization? There have certainly been large increases over the last forty years in the integration of national markets for both traded goods and financial flows, but this does not mean in itself that the ensuing market arrangements incorporate all countries of the world in any way evenly. What has been seen is the emergence of particular globalization 'hot-spots' centred on the most advanced industrialized countries, within which there has been a significant intensification of cross-border economic activity. At the same time many of the poorer countries of the world remain largely untouched by the new economic structures and appear to have little connection to these globalization hot-spots.

Partly this is an issue of development, because the organization of cross-border economic activities has tended to focus only on the most advanced sectors of the world economy. Partly it is an issue of political asymmetries within the regulatory system for global trade and global finance, with the advanced industrialized countries keeping most of the economic gains from globalization for themselves. As development issues are dealt with elsewhere in the book—see, in particular, Chapter 28—this chapter focuses instead primarily on the regulatory principles on which global trade and global finance are today grounded. The aim is to highlight the means through which the balance of power within the inter-state system is imprinted on the regulation of global trade and global finance. This will enable students to conceptualize the tendency towards economic globalization as a deeply uneven historical process.

The current regulation of global trade

When treated as a purely economic phenomenon, the most frequently cited indicator of globalization is the eye-catching intensity of the increases in world trade witnessed in the last forty years. This is demonstrated best by looking at standardized figures for the volume of world exports, because this allows for meaningful direct comparisons to be made. Taking the 2000 figure as the baseline number of 100—which itself corresponded in value terms to approximately US$8.6 trillion of world trade—this compares with standardized numbers of 22 for 1970, 37 for 1980, and 54 for 1990. In other words, the volume of world exports grew by roughly a factor of 5 between 1970 and 2000, a factor of 3 between 1980 and 2000, and a factor of 2 between 1990 and 2000 alone. This signifies an accelerating trend, and further increases in global trade after 2000 continued to be marked until the destabilizing impact of the **sub-prime crisis** of 2007/8. Between 2000 and 2006 the dollar value of global trade leapt from US$8.6 trillion to US$11.8 trillion.

The figures also show that the world economy was becoming more systematically open to global trade from the 1970s onwards. The relevant indicator here is the ratio of growth in global trade to growth in global **GDP**. If the two numbers are exactly the same, and therefore the ratio is 1:1, all increases in world export demand are fully accounted for by the fact that the world economy is becoming richer as a whole and not by the fact that it is becoming generically more open to trade. However, taking 1970–2000 as a single time period, the ratio was 1.77:1, showing that increases in global trade were almost double those of global GDP. Between 2000 and 2006 the ratio was 2.06:1, or slightly more than double (all figures calculated from World Trade Organization 2007).

Box 27.1 What is international trade?

At its most basic, international trade occurs when the citizens of one country produce a good that is subsequently consumed by the citizens of another country. There is consequently a geographical mismatch between the site of production and the site of consumption, with the good travelling across at least one national border so as to connect the producer economically with the consumer. The country producing the good for sale elsewhere in the world is the exporter; the country in which the good is eventually sold is the importer.

The body that today is formally charged with overseeing the regulation of all this export activity is the **World Trade Organization** (WTO). This is a relatively new institution, having been established only in 1995. It replaced what was only ever intended as an interim body, the **General Agreement on Tariffs and Trade** (GATT), but which had regulated global trade since 1947. The GATT provided a negotiating context in which any country could extend tariff concessions agreed bilaterally to third countries. Yet by the 1990s it had become increasingly unsuited to the purpose for which it was designed (Hoekman and Kostecki 2009). As new entrants emerged within global trade patterns, the need to negotiate every third-country contract individually meant that the whole process had become almost entirely unwieldy (Mavroidis 2008).

Box 27.2 The Most Favoured Nation

The Most Favoured Nation (MFN) principle provided the bedrock of GATT negotiations, being formally laid down in GATT Article I. It stated that any preferential trading agreement reached with one country should be extended to other countries. The aim—which also continues to be the case under the WTO system—was to disqualify countries from using asymmetric tariffs in order to impose higher trading costs on one country than on another. The assumption underpinning the MFN principle is that a higher proportion of world GDP will be traded globally when trade takes place on a level playing field. The principle has been distorted, however, by the move towards regional trading blocs such as the European Union (EU), the North American Free Trade Agreement (NAFTA) and the Association of Southeast Asian Nations (ASEAN). Such arrangements allow countries to set lower tariffs for their in-bloc trading partners than for countries outside the bloc. This is why some globalization purists argue that regional trade agreements are an impediment to genuine economic globalization.

The WTO prides itself on being a member-based organization and, as of early 2010, it had 153 members. The majority of these members are developing countries, 32 of which have the United Nations-approved designation of Least Developed Country. The principal export goods for many developing countries are in agriculture and textiles, and these sectors are among the least comprehensively covered by the WTO's free trade agreements (McCalla and Nash 2008). This means that the incentives of membership for such countries lies less in the direct welfare gains resulting from enhanced export earnings than in other mechanisms.

Most developing countries have fragile public finances, and they depend for their continued financial viability on the capacity to tap the global financial system for flows of investment capital originating from overseas. In general, if they are to benefit from inward capital flows, such countries need to secure a positive assessment of their economic outlook in the regular country reports written by the **International Monetary Fund** (IMF). This in turn revolves around finding ways of assuring global investors that the rule of law is sufficiently established to prevent the state from appropriating overseas financial investments and to guarantee that the success of those investments will be determined solely by market mechanisms (Sinclair 2005). Membership of the WTO ensures not only that its specific free trade rules are internalized, but also that its broader market-based mindset permeates the general approach to issues of macroeconomic management. For many developing countries, then, joining the WTO is as much as anything a signalling device designed to offer assurances to global investors that any money committed to their country is likely to remain safe. Decisions about WTO membership for such countries are thereby shot through with global power relationships. The WTO is much more important to them than their membership is to the WTO.

The same is not true if we look instead at the situation of the countries of the **G7** in general and the USA and the European Union in particular. With their huge consumer markets and their ability to reposition small economies in effect as their trade captives, it would be possible for them—albeit almost certainly more time-consuming and more costly—to create exactly the same trading relationships in a series of bilateral agreements as membership of the WTO creates for them multilaterally. The export sectors of many developing countries are oriented almost solely to trade either with the USA or the EU, and if they refuse to abide by the demands of their larger trading partner, the retaliation for independently

minded behaviour is likely to come at a considerable cost to their export earnings. The credibility of the USA and the EU within the global trading system arises from the power that follows their dominant position with respect to smaller trading partners, not from their membership of the WTO. The credibility of the WTO, by contrast, is wholly dependent on keeping the USA and the EU on board and engaged as active participants. This gives the USA and the EU significant hold over the policy output of the WTO.

The structure of decision-making at the WTO consequently reflects the fact that power is not distributed symmetrically among the institution's membership. The WTO is in appearance the most democratic of all the principal multilateral governance institutions, because it has legally enshrined formal provisions for a 'one member, one vote' decision-making structure (Footer 2006). In practice, however, these provisions are generally overridden by the requirement for members to agree to a package of reforms in its entirety for fear that the ongoing round of multilateral trade talks will collapse if they do not (Narlikar 2003). Votes are not taken on individual measures to build up incrementally a body of international trade law that is acceptable to a majority of WTO members. Instead, members must decide whether to accept as a whole—with no possibility of individual opt-out clauses—a package of reforms known as the **Single Undertaking**.

This package is largely agreed in advance of WTO Ministerial Meetings; the politics of the meetings themselves subsequently tend to focus on finding strategies of persuasion to secure the nominal consent for the Single Undertaking from reluctant members (Gallagher 2005). The process of pre-agreement is overwhelmingly one-way and a reflection of the prevailing global balance of power: the most developed countries have clearly defined access to the process, but the vast majority of developing countries do not. The USA and the EU hold the most prominent position in this respect, increasing the likelihood that their interests will be satisfied by the outcome of Ministerial Meetings. The politics of persuasion at those meetings is also overwhelmingly one-way: it is the most developed countries that seek the developing world's incorporation into their trade agendas, not the other way round. The USA and the EU take much larger diplomatic delegations to Ministerials than any other country in an attempt to increase the chances that other countries will sign up to the Single Undertaking. This merely multiplies the advantage they already possess in having by far the largest diplomatic missions in constant contact with the WTO at its permanent headquarters in Geneva (Koul 2005).

Box 27.3 'The Quad' at the WTO

With over 150 members, perhaps the most important issue for the WTO is whether it embraces a decision-making structure that is effective but exclusionary or a decision-making structure that might prolong negotiations but allows each member a genuine say in their outcomes. Until now it has consistently resolved this tension by emphasizing efficiency in reaching final decisions over the democratic credentials of the decision-making process. One of the more striking images of the failed Ministerial Meeting at Seattle in 1999 was of trade delegates from developing countries standing alongside protestors outside the negotiating hall and lining up to brief the world's press about how they had been excluded from the decision-making process.

The actual decision-making process at Ministerials is typically open to at most twenty members: all the most powerful developed countries plus representatives of other groupings within the WTO. Bangladesh, for instance, often represents the whole of the 32-member Least Developing Countries grouping. Even here, these twenty members do not begin the trade negotiations from scratch. Rather, they are presented with a pre-agreed list of priorities negotiated before the Ministerial Meeting by members of the Quad. Historically, the Quad—otherwise known as the G4—consisted of the USA and the EU (the two global trade powerhouses), Japan (with its ability to bring Asian countries into agreements), and Canada (balancing EU with NAFTA interests but also representing Cairns Group concerns for agricultural liberalization). With subsequent changes in internal power structures within the WTO, however, there are now competing G4 groupings. A new Quad has emerged, comprising the USA and the EU (still the powerhouses), Brazil, and India (newly industrializing countries with huge potential consumer markets but positioned differently on the question of agricultural liberalization). Whichever G4 grouping prevails on any particular issue, most developing countries still have no access to agenda-setting power.

The impact of the global balance of power on outcomes is much more visible under the WTO system than it was under the preceding GATT system. Even though it was evident there too, the process of complex multiple bilateral negotiations of trade norms under GATT—as opposed to the Single Undertaking requirement to commit to tightly specified multilateral trade norms under the WTO—ensured that there was greater political space for developing countries to escape policies that they believed ran clearly counter to their interests. The existence of that political space was re-described by proponents of genuinely multilateral trade rules as nothing more than legal loopholes that were detrimental to the objective of global free trade. However, its subsequent eradication and the associated exposure of developing countries to other people's agenda-setting power has led to accusations from the WTO's critics of its inherent democratic deficit and to concerted opposition to its influence (Howse 2007).

The Ministerials at Seattle in 1999 and Cancún in 2003 were subjected to such high-profile protests from civil society groups that subsequent Ministerials have been scheduled for places much less accessible to such global gatherings (Jones 2004). The WTO is charged by its critics with running a wantonly asymmetrical trade system, vigorously pushing back the frontiers of free trade in areas like intellectual property rights, where developed countries benefit at developing countries' expense, but blocking free trade in areas like agriculture, where the roles would be reversed. Even if this is merely evidence of the operation of the global balance of power, it shows that the WTO is faced with a very real dilemma. While it could not survive as a credible multilateral institution without the active participation of the trading powerhouses of the USA and the EU, the practical implications of their actual participation as agenda-setters denies the WTO the status of a credibly democratic institution (Tabb 2004).

Key Points

- The decision to disband the GATT in favour of the law-making WTO system was an attempt to create more straightforward negotiations for global free trade.
- Developing countries voluntarily sign up to become members of the WTO, but their choice to do so is often heavily influenced by the political pressures that are placed upon them to demonstrate their commitment to providing a business-friendly environment for global investors.
- When they act in concert, the USA and the EU are almost always able to get their interests imprinted into WTO law, even if majority opinion among WTO members points in a different direction.

The current regulation of global finance

The regulation of global finance also suffers from civil society accusations of democratic deficit, even though this particular structure of regulation has none of the democratic pretensions associated with the WTO (Gill 2008). The contents of global financial regulation are decided largely within expert rather than political communities, and the objectives of global financial regulation are determined almost solely by the countries that finance the maintenance of the regulatory system. The two principal bodies in this respect are the International Monetary Fund and the **World Bank**, both of which date to the original **Bretton Woods** agreements of the 1940s. The formal task of the IMF is to provide short-term monetary assistance to countries struggling with financial instability, that of the World Bank to provide longer-term monetary assistance to countries seeking enhanced development prospects. Both institutions prefer to present themselves as providing purely technical help to countries in economic distress. Yet their willingness to embrace the use of **conditionalities** in return for loans immediately politicizes their activities. It produces a context in which national politicians have often had to ignore their electoral mandates and sacrifice their political legitimacy accordingly in order to satisfy the institutions' demands.

Box 27.4 Why are conditionalities politically [illegible]

IMF and World Bank conditionalities are so named because they ensure that countries qualify for financial assistance not on the grounds of the need within their impoverished communities, but only on condition that they follow the policy objectives laid down by the institutions. This provides IMF and World Bank officials with the power to determine policies in many developing countries, sometimes taking that power away from democratically elected governments. The Bretton Woods institutions have often been accused by their critics of selecting policy objectives drawn from within the ideological perspective of Western free market capitalism, thus destroying local economic customs and traditions and leading to the forced reconstitution of local economic lifestyles. In this way the critics allege that the institutions operate as covert agents of Western foreign economic policy, preparing developing countries for investment by Western firms.

The IMF and the World Bank draw dissent from civil society activists not only because of their policy interventions in supposedly sovereign countries, but also because they are the most visible formal symbols of the institutionalized power of global finance (Porter 2005). A widespread perception exists today that this power has increased *considerably* since the 1970s (Duménil and Lévy 2004). Talk has turned increasingly to the way in which financial markets routinely discipline the political

aspirations of all political parties seeking election to government, especially those parties exhibiting specifically social democratic aspirations to defend the existing scope of welfare entitlements within society. It is almost certainly no coincidence that most social democratic parties have moved quite substantially to the right on questions of monetary policy in the intervening years, increasingly endorsing conservative monetary policies designed to hold inflation in check because this is what they believe financial markets want to hear (Notermans 2007).

The image being depicted in talk of disciplinary effects is that of a transferral of power, whereby individuals working within private financial institutions have usurped the power traditionally ascribed to governments under systems of representative democracy. The economic fate of populations is therefore not necessarily in their own hands, their choice of what policies to vote for being largely pre-empted by the ability of financial markets to override decisions to which they are opposed (Demmers *et al.* 2004). Private financial institutions—most prominently banks—have a vested interest in the defence of the existing price structure of financial assets, because their wealth and that of their shareholders is intimately linked to that price structure (Watson 2007). That defence typically involves the introduction of strict counter-inflationary policy in order to ensure that inflationary pressures are squeezed out of the economy as a whole. Currency traders have shown themselves to be only too willing to sell off the currencies of countries where they doubt the strength of the government's counter-inflationary commitment. These are attempts to ensure that the government moves quickly to give them a policy more to their liking.

The average daily turnover on world **currency markets** is now roughly US$2.1 trillion (Bank for International Settlements 2007). To write that out in long-hand requires the addition of eleven noughts after the '2' and the '1'. This *daily* volume compares with the *yearly* volume of all world trade of approximately US$11.8 trillion in 2006 before the onset of the sub-prime crisis. Flows of global finance consequently completely dwarf flows of global trade, with the dollar value of currency market turnover alone being approximately sixty-five times higher than the dollar value of all countries' export activities in aggregate. A large majority of the roughly US$2.1 trillion of daily turnover on world currency markets now represents currencies being bought and sold for purely speculative purposes (Kenen 1996). Such speculation represents two things. On the one hand, it is a bet placed on the power of private financial institutions to force the movement in relative currency prices that they most desire. On the other hand, it is a bet placed against governments' ability to maintain a truly autonomous policy course in the face of the disciplinary power of private financial institutions.

Box 27.5 The Mitterrand U-turn in 1983

The single most influential instance in which financial markets appeared to override the mandate of a democratically elected G7 government occurred in the early 1980s in France. The elections in 1981 of François Mitterrand as President and Pierre Mauroy as Prime Minister, in close proximity, paved the way for a potentially decisive period of Socialist Party government. Initially, policy followed the platform on which Mitterrand was elected, choosing a course that was massively at odds with the neo-liberal programmes then being pursued in the USA under Reagan and in the UK under Thatcher. Mitterrand had promised to bring about economic recovery through large injections of government spending into the economy and to change the balance of power in the economy by nationalizing key industries. This became known as his 'Keynesianism in One Country' strategy, and Mauroy pursued it vigorously at first. However, the combination of policies produced new sources of inflation, and private financial institutions reacted by selling francs in large amounts in an attempt to destabilize the national currency and hence increase the likelihood that the government would reverse its policy course. After months of rearguard action to quell the pressure on the franc, Mitterrand bowed to the wishes of financial interests in 1983, abandoning his Keynesian strategy and adopting something much more like the neo-liberal alternative then in vogue in the USA and the UK. No G7 country has since attempted such a bold strategy in the face of the perceived power of financial markets. More than any other, the Mitterrand U-turn is the signal event that sealed in the popular imagination the intense power of global financial markets, forcing an elected government of one of the world's most advanced industrialized countries into a humiliating climb-down from its preferred policy course.

Speculative flows on world currency markets are such a big problem for governments because on a daily basis they are more than twice the size of the foreign currency reserves held in the central bank vaults of all IMF member states put together. This pretty much guarantees that coordinated speculative attacks will always be successful. The effects of such attacks can often be devastating, both economically and socially. During the **Asian financial crisis** of 1997/8, for instance, four of the five worst-hit countries—Thailand, South Korea, the Philippines, and Malaysia—saw the value of their currency fall 30 per cent in dollar terms (Stiglitz 2002). In other words, the people of those countries on average were able to buy only around two-thirds of the volume of

goods at world prices after the crisis as had been possible before it. The fifth country, Indonesia, fared even worse. Its currency finally stabilized in 1998 at a dollar value 70 per cent below its level of twelve months previously. This meant that private financial institutions' speculation against the rupiah deprived the average Indonesian of almost three-quarters of his or her pre-crisis spending capacity (Grabel 2003). Altogether unsurprisingly in such circumstances, these five countries between them witnessed 80 million new cases of poverty between 1997 and 1998 (Thirkell-White 2005).

The IMF's response to the Asian financial crisis was much more decisive and much more in keeping with the reputation it has developed for itself as a free market ideologue than was its response to the sub-prime crisis that engulfed Western banks in 2007/8. In the latter case, it sat on the sidelines for pretty much the whole time as the crisis unfolded. It simply did not have the scale of resources at its disposal to help stabilize the beleaguered Western banks. Instead, it was left to offer verbal rather than monetary support to Western governments as they introduced interventionist programmes to keep their banks in business. This proved to be the first time since the IMF's ideological embrace of free market principles in the early 1980s that it had not come out strongly in favour of those principles when faced with examples of systematic government intervention to stabilize crisis-hit countries (Blustein 2001).

This has never been clearer than in the response to the Asian financial crisis, where stabilization assistance was made conditional upon the governments of the crisis-hit countries *not* using public debt to recapitalize their banks. The IMF's concern was that governments within the region were already too active in influencing the way that their countries' banks lent money; it wanted the banks to allocate available sources of capital more on the basis of matching supply to demand and less on the basis of political decree. The means it selected to achieve such an objective was to organize for ownership of East Asian banks to pass from Asian hands to US and EU hands (Robertson 2008). It thought that this would lead to an important demonstration effect about how to run a purely market-based financial system successfully, because the extra experience that high-level American and European managers had of working within such a system would quickly diffuse to their Asian counterparts. As a historical footnote, there is an obvious irony to explore here, given what has happened to American and European banks since.

Box 27.6 Contagious currency crises

The Asian financial crisis of 1997/8 continues to provide arguably the best example of what economists call 'contagious currency crises'. These are speculative attacks against currencies that appear to jump across borders as they affect one country and then another in very similar ways over a very short space of time. The Asian financial crisis began as the bursting of a real-estate bubble in Thailand exposed systematic over-investment throughout the economy in risky assets. Speculation then started against the Thai national currency, the baht, until its price was pushed down against the dollar as a reaction to the ultimate failure of the preceding construction boom. At that point speculation ensued against the currencies of near neighbouring and not-so-near neighbouring countries, even though those countries had no real economic connection to the Thai real-estate bubble. The famed financier George Soros (1998) likened the actions of global financial markets to those of a giant 'wrecking ball', as they moved from one Asian country to another leaving a trail of destruction in their wake.

This transfer of ownership served as a catalyst for the most noticeable change in the structure of global financial flows between the late 1990s and today. Despite the continued rise of East Asia in global trade and the emergence of China as a genuine trading powerhouse, global financial flows have not followed the same pattern. In relative terms at least, East Asia has been increasingly bypassed as global financial flows have been concentrated elsewhere within the world economy. Recent figures from the McKinsey Global Institute show that there are only three bilateral relationships in the world economy where the dollar value of annual financial investment flows amounts to more than 10 per cent of world GDP. These are the flows between the USA and the UK, the UK and Western Europe, and Western Europe and the USA (cited in Hirst, Thompson, and Bromley 2009). According to the McKinsey figures for 2007, 64 per cent of the world's US$196 trillion of financial assets was held within the USA, the UK, and Western Europe.

Global finance is therefore spatially concentrated in the North Atlantic economy. Indeed, the concentration is so marked—and intensifying—that the adjective 'global' is questionable as a description of the character of financial flows within the world economy. Perhaps more importantly for current purposes, though, the willingness of the IMF to allow governments to use public money to bail out banks following the North Atlantic financial crisis of 2007/8 but not following the Asian financial crisis of 1997/8 suggests that the heavy spatial concentration of supposedly global financial flows translates into similarly concentrated political effects.

It certainly raises the possibility that the predominance of the North Atlantic economy within global finance gives the USA, the UK, and Western Europe additional leverage in their dealings with the IMF. The same was shown to be true in the previous section with respect to the WTO, so here is one way in which the regulatory politics for global finance follow very similar contours to those for global trade.

Key Points

- The dollar value of total domestic financial assets is now considerably larger than the world economy's aggregate productive capacity, in 2007 amounting to almost four times the US$55 trillion figure for world GDP.
- The fact that speculation dominates the way in which assets are bought and sold on global financial markets places often quite exacting constraints on government autonomy over the conduct of economic policy.
- The regulatory structure over which the IMF presides operates asymmetrically, consistently favouring the interests of the most advanced industrialized countries.

A brief history of market self-regulation in trade and finance

The regulation of global trade, as has been demonstrated, takes place independently of the regulation of global finance. Yet today there are complementarities in the dominant regulatory form across the two spheres, because *in general*—see above for discussions of important exceptions—both the WTO and the IMF aspire to create systems of inter-state economic engagement that respond first and foremost to market-based signals. Market prices alone are typically used to guide economic behaviour towards particular outcomes. This is an obvious political experiment with **market self-regulation**, and there have been other similar experiments stretching back a long way into world economic history.

The first occurred in the seventeenth century. This was the era of the giant **stockholding companies**, the precursor of the modern **multinational corporation**. These were firms that raised capital to invest overseas, so that they could develop a trading infrastructure that would allow them to acquire products in the territories in which they operated for subsequent sale back home (Robins 2006). There were pretty much no legal restrictions on the activities of the giant stockholding companies, because they were typically established by royal charter. This provided them with the right to operate in distant territories at their sovereign's behest so as to appropriate wealth in the name of the nation. There were also precious few moral restrictions on the activities of such companies, because they acted far away from any effective means of oversight, often operating as much as a year's sailing time from their country of origin. They consequently appropriated wealth in distant territories by force, setting up imperialistic governance structures and using private militias as a means of defending the efficacy of those structures. Land was seized and peoples were subjugated in order to guarantee the profitability of the companies' trading strategies (Keay 1993). Very simply, market norms were imposed by brute force.

Box 27.7 The 'disembeddedness' of contemporary global finance

Just before the end of the Second World War, the left-wing émigré intellectual, Karl Polanyi, published a famous book of far-reaching implications on the economic causes of the European embrace of fascism in the 1930s. The book—*The Great Transformation* (Polanyi 1957 [1944])—was recognizable from the lectures he gave to the Workers' Educational Association in London as the crisis unfolded. In it, he drew an important distinction between two generic models of the market economy.

The first is when markets are 'embedded' within society. In such situations, price signals are rendered subsidiary to societal welfare. Whenever there is a trade-off between the two, policy outcomes obstruct the pure manifestation of the price mechanism and prioritize welfare-enhancing interventions instead. By contrast, 'disembedded' markets render society functional to the unimpeded operation of price signals, and any tension with societal welfare is resolved this time to preserve the purity of the price mechanism. Crucially, Polanyi suggested that society would always be minded to organize politically against the uninhibited encroachment of disembedded markets—whether to far-right ideologies as was the case in the 1930s, or to more progressive alternatives.

The original Bretton Woods agreements created a regulatory system for finance clearly consistent with Polanyian embeddedness. Elaborate structures of capital controls ensured that finance remained largely tied to the national economy, thereby serving the creation of national systems of social protection. By contrast, more modern forms of financial regulation assert globalization as their policy goal and champion the merits of disembeddedness accordingly: Polanyian disembeddedness equates to market self-regulation. As yet, a concerted societal backlash has not reversed this situation, certainly not in the direction of a more progressive political settlement, but far-right parties have recently made gains in many countries by offering avowedly nationalist alternatives to the perceived social dislocations of globalization.

Box 27.8 The East India Companies

Britain, the Netherlands, Denmark, Portugal, France, and Sweden all had their own East India Companies by the eighteenth century, allowing them to operate the trading route centred on modern-day India. As can be seen by this pattern of establishment, the giant stockholding company was a European—and pretty much a Europe-wide—phenomenon. It was a manifestation of the contemporaneous struggle amongst the European powers for territorial expansion, and as such these companies carried with them both the instinct and the physical infrastructure for colonizing faraway lands. The East India Companies sold shares within their respective 'mother countries' in order to fund both their voyages and the creation of colonial settlements through which the voyages could be turned into a commercial success. Finance flowed out of the mother country to provide the Companies with their operating capacities, but then flowed back in the opposite direction to subsequently provide the Companies' shareholders with a return on their investments. This was achieved by transporting goods from the colonies back to the mother countries where they could be sold at a profit to the new middle classes who were eager to transform their lifestyles through the consumption of exotic products. The East India Companies therefore instituted an integrated structure of global trade and global finance.

The regulation of global trade and global finance also revolved around a system of market self-regulation in the late nineteenth and early twentieth centuries. Britain used its status as the dominant world economic power of the time to introduce a system through which market-based financial flows between two countries would correct any imbalance that developed in market-based trade flows between them. This was the **Gold Standard** system, which worked as an automatic adjustment mechanism designed to impose market logic onto the prevailing patterns of global trade and global finance (Cohen 1977).

Under the Gold Standard system, imports were paid for using gold, where each national currency was freely convertible into gold at a pre-determined and fixed rate. If a country was experiencing a deficit on its **balance of trade**—i.e. it was importing more for its citizens' consumption than it was exporting for other countries' citizens' consumption—gold would have to flow out of the country in order to finance the purchase of the additional exports (Gallarotti 1995). There was a strongly held belief among economists at the time that market logic alone was sufficient to ensure correct adjustment. Economic theory suggested that the outflow of gold would contract the domestic money supply and, from there, depress the general price level at home. This would reduce the level of imports coming into the domestic economy (because goods produced overseas would suddenly become less affordable compared with goods produced domestically), and at the same time increase the level of exports going out of the domestic economy (because goods produced domestically would suddenly become more affordable to overseas citizens compared with goods produced in their own countries). If the theory was correct, the global flows of finance as gold moved from one country to another should have perfectly counteracted the initial imbalance in global trade and restored balance to the world economy as a whole (Eichengreen 1996).

While the overall tendency in the regulation of global trade and global finance over the last four centuries has been towards market self-regulation of one form or another, this has by no means been a permanent feature of the world economy. Indeed, the most frequently discussed regulatory settlement within the International Relations literature—that of the Bretton Woods system of the immediate post-Second World War period—was constructed on the basis of introducing deliberate obstacles to the application of pure market logic (Helleiner 1994). The Bretton Woods system facilitated government intervention to direct flows of global trade and global finance, and the IMF and the World Bank were created under that system in order to defend the boundaries of feasible intervention. One of the ironies of the most recent reversion to a system of market self-regulation is that those same institutions now routinely discipline governments against intervention in order to promote and to sustain market logic (Harvey 2007).

The Bretton Woods Conference was held in 1944 in the New England town of that name. The Conference was attended by 44 soon-to-be victorious Allied countries from 1 to 22 July of that year. It was organized in an attempt to design a post-war governance structure for the Western world that would prevent the world

economy from returning to the Great Depression that had so blighted lives and livelihoods in the preceding decade. The famous English economist, John Maynard Keynes, had argued throughout the 1930s that the Great Depression had been caused by the prevailing system of market self-regulation. He had dissented strongly from orthodox economic opinion and argued that the automatic adjustments of the Gold Standard were much more socially destructive than the entirely benign corrective mechanism depicted by economic theory (Keynes 2009 [1963]). He showed that it was output rather than prices that adjusted to global imbalances in trade, thus forcing national economies into a repetitive cycle of reduced production and job losses. The ensuing severe rises in unemployment preceded the political mobilization of many European populations to radical right-wing ideologies in the 1930s, and Keynes was determined that the structure of global trade should be stabilized in order to prevent history from repeating itself on this point.

His priority was to create a multilateral institution that would facilitate continual expansions in global trade. The proposed institution was to be called the International Trade Organization (ITO). However, concerted dissent domestically within US politics meant that President Truman did not even bother sending the final bill to Congress for ratification. It was deemed too interventionist for US politicians' tastes, for it would have introduced common conditions on things such as labour and environmental standards in order to create a genuine level playing field for the conduct of global trade (Deese 2007). An ITO without the USA, in the 1940s by far the world's largest exporter, was deemed unthinkable. The plans for its introduction were therefore hastily dropped, leading to the establishment instead of an ostensibly interim institution—the GATT—which eventually survived for 48 years before being superseded by the WTO. This was the earliest example of a single member being more important to a multilateral trade institution than the institution would have been for the member.

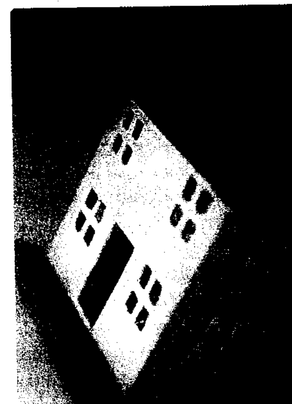
The failure of the ITO proposals meant that only two institutions were created at Bretton Woods: the IMF and the World Bank. Both institutions have embraced quite substantial elements of mission creep since their inception. As formally inscribed in the original Bretton Woods agreements, the priority of global economic governance at the end of the Second World War was to stimulate free market flows of traded goods rather than to stimulate free market flows of finance. Successful long-term development was assumed to be the outcome of stable trading conditions, and in an attempt to enhance such stability obstacles in the form of **capital controls** were placed upon the movement of finance between one country and another (Crotty and Epstein 1996). Market self-regulation of finance was formally disqualified in this period. The IMF was responsible for policing such a system, ensuring that capital controls remained robust and that private financial institutions were unable to circumvent them (Goodman and Pauly 1993). In effect, the IMF was initially designed as a subsidiary regulator of global trade—or, at the very least, as the regulator of heavily restrictive global financial conditions in which trade could flourish.

In the immediate post-Second World War period, then, strict limits were placed on the globalization of finance. The US Treasury Secretary of the time, Henry Morgenthau, celebrated the political curtailment of the economic liberties of private financial institutions by declaring that the goal of Bretton Woods had been to 'drive the usurious moneylenders from the temple of international finance' (cited in Gardner 1980: 76). This had echoed in discursive form Keynes's account of his desire to oversee 'the euthanasia of the rentier' (Keynes 1997 [1936]: 376). Yet the political settlement that cast finance in the role of servant to the rest of the world economy was to prove only short-lived. In a series of steps between 1971 and 1973 the Nixon administration first backed the USA away from its currency responsibilities within the Bretton Woods system and then formally reneged on them altogether (Strange 1994). The system relied on US dollars being available freely within the world economy at a fixed rate relative to the price of gold, which had the effect of fixing all exchange rates with respect to one another. Once the Nixon administration had allowed the value of the dollar to be set by global financial market activity rather than by government commitment to currency pegs, all currencies eventually floated against one another. As soon as this happened, incentives arose for the advanced industrialized countries to dismantle their capital controls in an attempt to attract flows of global finance. This they duly did, and the shackles that Bretton Woods had placed on global finance were released. The origins of today's experience of an increasingly politically powerful financial sector can be dated to this time (Posen 1993).

Key Points

- The regulation of both global trade and global finance is oriented today towards a system of market self-regulation, but as the Case Study shows, this increases the vulnerability of one sphere to shocks arising from the other.
- Under the Bretton Woods system of the immediate post-Second World War era, finance was stripped of its global activities and generally boxed in by political decree so that it would serve the interests of stable global trade relations.
- The evolution of the regulatory system typically follows really quite closely the perceived needs of the world's most powerful economies at any particular moment of time.

Case Study: The sub-prime crisis



The sub-prime crisis brought significant numbers of Western banks to the point of going out of business in 2007 and 2008 (Cohan 2009). Only public bailouts of unprecedented magnitude prevented individual crisis-hit banks from spreading their own financial woes contagiously around the whole sector and leading to mass defaults on accumulated banking debts. In many ways the sub-prime crisis was a crisis of market self-regulation. It arose because of the extent to which Western banks had misread available price signals and poured seemingly endless sums of money into making cheap mortgage credit available (Schwartz 2009). House prices rose steeply in most Western countries from the end of the 1990s, temporarily masking the difficulties that the banks were bringing upon themselves. Yet when the housing market boom first began to unravel globally in 2007, the banks discovered the full extent of their over-exposure to the so-called **'toxic assets'** of **mortgage-backed securities**. A structure of adequate public authority over banks' activities simply did not exist to stop them from getting themselves into such deep trouble (Shiller 2008).

The sub-prime crisis has triggered a number of different cycles of political recrimination and response. Governments have tended to blame banks for creating the credit bubble that was the proximate cause of the crisis, but they have none the less still bailed them out using enormous sums of taxpayer money. Banks have tended to blame their customers in mortgage lending markets for borrowing irresponsibly at the rates made available to them, and they have significantly tightened repayment schedules as a consequence. Voters have tended to blame their governments for having allowed banks to operate for so long in such a lightly regulated environment, although the early post-crisis patterns of anti-incumbency voting have typically rewarded parties who also favoured bank deregulation in the pre-crisis period.

Each of these three groups in their own way contributed to the manner in which the problems developed, yet this does not make them all equally culpable for the eventual mess into which the world economy descended. It is true that many people in many countries significantly over-leveraged themselves in trading up on the property ladder as house prices rose steeply in the period immediately preceding the crash. However, if the banks had not made extremely cheap credit available to them in the mortgage lending market, the option of over-leveraging would not have been available to them in the first place. Banks took to lending in this way because they were making lots of money in secondary mortgage markets from selling mortgage credit as quickly and with as little fuss as possible. Whistleblower reports subsequently emerging from within the banking sector suggest that due diligence tests on customer creditworthiness were largely suspended as the credit bubble hit its peak (Muolo and Padilla 2008). In the USA, for example, **'liar loans'** temporarily became a particularly profitable niche product for many banks, so called because they required customers merely to state a level of household income to qualify for a loan rather than to demonstrate that actual earnings matched stated earnings.

This raises the question of why governments did not do more to prevent the development of the credit bubble by imposing more exacting regulations on banking activity. The dominant policy trajectory worldwide for the past four decades, of course, has been the opposite one of financial liberalization, and the liberalizing trend has had strong support from the International Monetary Fund, the World Bank, and strategically significant countries of the G7. Restrictive banking legislation therefore has not fitted with the temper of the times since the collapse of the Bretton Woods settlement in the early 1970s, especially as the banking sector has come to increased prominence in most countries in terms of its ever-greater contribution to national GDP. The liberalizing trend aside, though, there seems to be one factor specific to the recent credit bubble that appears to explain governments' reluctance to intervene against it. The credit bubble fed increases in house prices, the buoyant housing market fed enhanced feelings of wealth among the population, and these feelings in turn fed heightened consumer confidence. The resulting consumer boom created the growth dynamics that all governments treat as essential to their re-election prospects.

Conclusion

Following the downturn in the world economy in the 1970s, the move towards market self-regulation has been the most noteworthy trend in the spheres of both global trade and global finance. Economic globalization and economic theory have combined in this respect to reinforce the trend. Public discourse on the benefits of economic globalization has tended to emphasize the advantages of market arrangements; economic theory has always voiced strong support for such arrangements.

However, the complementarity of regulatory forms is not necessarily synonymous with an internally coherent regulatory system. Regulatory coherence arises only when there are overarching economic regime features that necessitate the imposition of regulatory constraints on one sphere in order to facilitate regulatory effectiveness in the other. The distinctly illiberal treatment of finance under the original Bretton Woods agreements was instrumental in maintaining the equally distinctly liberal treatment of trade. The two spheres now operate without the sort of checks and balances that symbolize a system of regulatory coherence. As a consequence, the feedback mechanisms between the two have been much enhanced, with instability in one often rebounding in different forms as instability in the other.

There has been a lot of talk following the sub-prime crisis of 2007/8 of the inadequate regulatory coordination between trade and finance under conditions of economic globalization. In particular, concern has been raised about the way in which this does not allow problems in either sphere to remain self-contained. The Director General of the WTO, Pascal Lamy, has been especially vocal in this respect, perhaps because the sub-prime crisis was a crisis originating in finance but impacting on trade. Spill-over effects from the instability caused by Western banks in 2007 and 2008 subsequently led to the largest post-Second World War year-on-year reduction in world trade in 2009: by recent historical standards the drop was a barely believable 9 per cent (World Trade Organization 2009). Despite this, the general context of market self-regulation continues to be defended by each of the multilateral governance institutions, because they claim that this is how best to promote dynamic economic conditions domestically. As a consequence, the immediate post-sub-prime crisis context looks to be one in which the dominant regulatory model trades off the hope that market self-regulation enhances domestic economic dynamism against the reality that it comes complete with an increased likelihood of crisis events.

Questions

1 What implications has the failure of the International Trade Organization had for subsequent attempts to tie trade globalization to the introduction of progressive social conditions of production?

2 Does the WTO promote genuine trade globalization or an asymmetric trade globalization favouring developed countries?

3 Assess the significance of civil society activism against the WTO at its Seattle Ministerial Meeting in 1999 for the way in which the institution now conducts its business. Did the protests make a difference?

4 To what degree is capital accumulation within financial markets now completely detached from the rest of the world economy?

5 Explain the way in which the IMF appears to have become all-powerful in its relationship with developing countries.

6 What are the mechanisms through which financial liberalization translates into enhanced disciplinary power for financial interests over government policy?

7 Do multinational corporations abuse their power when locating in developing countries today in a manner analogous to the abuses enacted by seventeenth-century stockholding companies?

8 Is there a link between the ultimate failure of the Gold Standard system in the 1920s and the Great Depression of the 1930s?

9 In so far as finance was the servant of world trade under the original Bretton Woods agreements, is it now unequivocally the master?

10 What was the role of Western banks in creating the mortgage lending conditions from which the sub-prime crisis originated?

11 Should the sub-prime crisis be viewed as the major export of the USA to the world economy of the past ten years?

12 Is a 'new Bretton Woods' necessary if regulatory coherence is once again to be introduced between the spheres of global trade and global finance?

Further Reading

Glyn, A. (2006), *Capitalism Unleashed: Finance, Globalization, and Welfare* (Oxford: Oxford University Press). A radical perspective on what has happened to societal welfare goals under the influence of financial market self-regulation.

Helleiner, E. (1994), *States and the Reemergence of Global Finance: From Bretton Woods to the 1980s* (Ithaca, NY: Cornell University Press). The best political history of the process through which governments negotiated away the capital controls of the original Bretton Woods agreements.

Narlikar, A. (2005), *The World Trade Organization: A Very Short Introduction* (Oxford: Oxford University Press). A comprehensive account of the politics of the WTO, but written specifically for the student audience.

Polanyi, K. (1957 [1944]), *The Great Transformation: The Social and Political Origins of Our Time* (Boston, MA: Beacon Press). The classic account of progressive societal struggle against disembedded financial markets and of the right-wing populism which can emerge when that struggle fails.

Scholte, J. A. (2005), *Globalization: A Critical Introduction*, 2nd edn (Basingstoke: Palgrave Macmillan). Provides students with a perspective on trade and financial globalization that consciously seeks to politicize those trends and pinpoint the potential for successful resistance.

Trebilcock, M., and Howse, R. (2005), *The Regulation of International Trade*, 3rd edn (London: Routledge). In-depth yet readable treatment of the historical evolution of the regulatory system for global trade.

Watson, M. (2005), *The Political Economy of International Capital Mobility* (Basingstoke: Palgrave Macmillan). An attempt to theorize the economics of financial market self-regulation, but from a perspective that is written to be understandable for non-economists.

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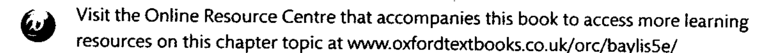

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