3. Who Governs? Economic Governance Mechanisms and Financial Market Regulation

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Who governs financial markets and financial market reforms? Which mechanisms are involved? And who plans or can be held responsible for the outcomes which ultimately not only affect the financial sector itself but also the real sector in the form of altered income distribution or changes in unemployment, to name but two examples? Outcomes that include or exclude the interests of different parts of society and increase or decrease the incomes and opportunities of various groups or individuals.

The financial governance debate stemming from international relations (IR) and international political economy (IPE) has addressed these issues (for a survey, see Underhill in this volume). One advantage of this debate is that it analyzes the complexity of global financial aspects as well as the overlapping structures of multi-level and global financial governance. It analyzes regulatory reforms in specific financial sub-sectors and stresses the democracy deficits that might accompany the new forms of governance at the global level.

However, the debate also has some deficiencies. In the following, three major weaknesses of the governance debate in general and of financial governance in particular will be addressed. First of all, the concept of governance is still vague. Section 1 thus gives a short overview of concepts of governance and shows that financial governance definitions have converged, but this has also reduced the richness of the original concept of economic governance. Today, every international agreement seems to have to do with some kind of network governance or private-sector governance. And every governance mechanism is supposed to be able to provide all kinds of positive outcomes for good governance.

Second, the economic governance literature originally drew a clear distinction between different types of governance and identified their

pros and cons, the interests they included and excluded, the stability they provided, etc. In today's financial governance literature there are either only two types of governance, the market and the state, or public and private authorities, or several types of governance in a strange combination. The types of economic governance have become blurred. Since the question of who determines the outcome and whose interests are being pursued was central to the original economic governance debate in comparative political science, which clearly distinguished between labor and capital interests, it seems worthwhile to bring back to mind the origins of this debate. Combining IR and IPE literature with the original thoughts from the economic governance debate in comparative political science therefore appears to be a promising way to bring important elements back into the debate. Section 2 shows how the original types of economic governance, the market, communities, networks, associations and the state are reduced in today's financial governance literature. A major deficiency of this development is the fact that power relations (i.e. the question of who governs) are no longer addressed adequately.

This brings us to the third deficiency of financial governance literature, which will be explored in Section 3. Who governs financial markets and financial regulatory reforms? In the financial governance literature, it looks as if it were nobody. A few actors from the private and the public sector negotiate issues, and this somehow has to be acceptable to the public. Some argue that the state has withdrawn and that it is the private sector which governs, but who do they mean? Others maintain that the state negotiates with the private sector and that the negotiations lead to some joint outcome. But who, then, determines policy? Unfortunately, Section 4 cannot give a definite answer to this question, but it will elucidate seven approaches which might be useful in the future for exploring who governs financial markets.

1. GOVERNANCE – IS THERE ANY CONVERGENCE OF CONCEPTS? AT WHAT COST?

Today, the term 'governance' is used with different connotations in a wide variety of fields and disciplines. Underhill (in this volume) gives a survey of the historical development of governance concepts in economics (focusing mainly on the regulation theory that started with Arrow and Stigler, and the classical political economy theories of Smith and Marx) and in contemporary political science (focusing mainly on rational choice approaches and international political economy as pursued by Coase and Olson, as well as international relations approaches, including his own). In a survey that focuses less on historical

development than on the use and meaning of the term in different disciplines and sub-disciplines, Hirst (2000) distinguishes five versions of 'governance', and Kersbergen and van Waarden (2004) extend this approach to find even nine different meanings of the term.

From the latter work, one can extract three major meanings of governance: good governance, governing without government and economic governance.

1.1 Good Governance

Recently the international relations term 'good governance' has been used increasingly in the field of development, where the World Bank and other international organizations are stressing sound or good governance. Bad governance, such as wasteful public spending, is being increasingly regarded as one of the root causes of all evil within our societies. Major donors and international financial institutions are increasingly basing their aid and loans on the condition that reforms are undertaken to ensure 'good governance'. Good governance has eight main characteristics: It is participatory, consensus-oriented, accountable, transparent, responsive, effective and efficient, equitable and inclusive, and it follows the rule of law. It assures that corruption is minimized, that the views of minorities are taken into account and that the voices of the most vulnerable ones in society are heard in decision-making (adapted from UNESCAP 2004).

Kersbergen and van Waarden (2004, p. 147) define corporate governance as 'good governance in the private sector'. The concept of 'corporate governance', which originally dealt with the enterprise, its internal structure and its transactions with its environment (see Unger 1997, Chapter 5; Lütz 2003, p. 5) deals with the accountability of management (Hirst 2000, p. 17). Corporate governance issues in the financial sector include, for example, whether managers have strong incentives to act in the shareholders' interest (fiduciary duty), the channels through which shareholders monitor and influence managers, the type of elections for the board of directors, the number of external directors, etc. (see, for example, Amable 2004, p. 24). While corporate governance brought good governance practices to the business sector, 'good governance in the public sector' can be found in new public management literature, which tries to introduce good governance into public organizations.

1.2 Governance without government

This concept also stems from international relations and refers to the possibility of governing without a government. International politics is

perceived as cooperation between independent states without a hierarchy. 'The international system is characterized by an anarchy of competing interdependent states that acknowledge no authority other than their own' (Kersbergen and van Waarden 2004, p. 145).

Another kind of governance without government is the self-organization of societies and communities. In her book *Governing the Commons*, Elinor Ostrom (1990) gives an impressive empirical overview of how different societies in different parts of the world have organized themselves in order to deal with the tragedy of the commons problem.

1.3 Economic Governance

The idea of economic governance is that markets are not spontaneous social orders but have to be created and maintained by institutions. Societies have produced a variety of institutions to govern economic transactions. Developed in the field of comparative political science, economic governance literature distinguishes different mechanisms of governance and analyzes their advantages and disadvantages for the economic performance of a country.

Since the seminal paper of Streeck and Schmitter (1985), 'economic governance' has become a popular term not only in political science but also in sociology and economics. It has branched off into many other fields in addition to labor relations and corporate relations, where it was originally developed. Sectoral governance, regional governance, supranational and global governance concepts eventually appeared as well.

Globalization has challenged the rather closed 'economy and politics' approach of economic governance. How do national actors and institutions react to global challenges? With globalization and the extension of the economic governance debate to IR and IPE literature, some major changes and modifications vis-à-vis the original economic governance debate have arisen.

With globalization, the problem of accountability also emerged. At the nation-state level, when the state delegates tasks to private authority, this is normally backed up by a rescindable mandate from the state. Thus, if citizens are affected negatively by the actions of private authorities, governments can hold these authorities accountable (Coleman and Porter 2000, p. 382). However, at the global level there is no such government.

The term '*multi-level governance*' was introduced in order to point out the co-existence of supranational (e.g. European), national and sub-national (regional) levels in a complex web of permanent interaction (Grossman 2005, p. 130).

1.4 Convergence in the Definitions of Governance?

Though the controversy surrounding the concept rumbles on, there seems to be some agreement nowadays that governance refers to the institutions, mechanisms or processes backed by political power and/or authority which allow an activity or set of activities to be controlled, influenced or directed in the collective interest (Commission on Global Governance 1995; Baker, Hudson and Woodward 2005, p. 5).

Kersbergen and van Waarden (2004, p. 151) also find some common characteristics in all the definitions mentioned above: First of all, the approach is pluricentric rather than multicentric (based on the market) or unicentric (based on the state). Governance deals with different forms and mechanisms of governance. Second, networks play an important role. Lately, the term '*network governance*' has even appeared in the EU (see Eising and Kohler-Koch 1999). Third, one can identify a clear emphasis on the processes of governing or functions as opposed to the structures of government. These processes are relatively similar in the public and private sectors and relate to negotiations, accommodation, concertation, cooperation and alliance formation rather than the traditional processes of coercion, command and control.

There seems to be some convergence in the definitions of governance. However, this convergence has had its costs. In the economic governance literature, there was originally a clear distinction between different types of governance, their pros and cons, the interests they included and excluded, the stability they provided, etc. Over time, these clear distinctions have become blurred. Today, every international agreement seems to have to do with some kind of network governance. And every governance mechanism is supposed to be able to provide all kinds of positive outcomes for good governance.

From an economic governance perspective, it makes a difference whether associations govern finance or networks of bankers, and the preconditions for good governance seem more like a child's Christmas wish list than a feasible concept. Good governance does not seem to be aware of the trade-offs between different institutions. A governance mechanism which provides consensus, most prominently associational governance in some neocorporatist setting, will not be transparent and participatory. A governance mechanism which is efficient and inclusive, such as the market, will not be very equitable.

It therefore seems worthwhile to remember the types of governance that have been mentioned in Streeck and Schmitter's seminal paper on economic governance and to describe their advantages and disadvantages.

2. ECONOMIC GOVERNANCE AND WHAT IT HAS LOST IN TODAY'S FINANCIAL GOVERNANCE DEBATE

2.1 The Original Economic Governance Debate in Comparative Political Science

A key feature of the 'economic governance' debate, initiated by Streeck and Schmitter (1985, 1985a) and extended by Hollingsworth, Schmitter and Streeck (1994), Powell (1996), and Boyer and Hollingsworth (1997), is that it regards the distinction between the state and the market or between the public sector and the private sector as insufficient for understanding who and what determines which economic and political activities take place in a society. In order to understand public policy, the antinomy of the state versus the market has to be augmented by a variety of 'governance mechanisms' between the market and the state (Streeck and Schmitter 1985). The debate originally stemmed from labor relations and systems of capitalist production, hence from real sector issues.

Building on typologies created earlier by Williamson (1975), Ouchi (1980), Streeck and Schmitter (1985) as well as Hollingsworth, Schmitter and Streeck (1994), we can distinguish the following governance mechanisms in an economy:

- the market;
- communities or clans, that is, informal groups which are based on primary relations such as the family and in which 'trust' is an important lubricant;
- networks, which can be formal and informal;
- associations, a more formal and goal-oriented form of social cooperation as compared to communities;
- the state.

This list of governance mechanisms can be extended to include firms (see, for example, Lütz 2003) and courts (van Waarden 2004).

Common to all these governance mechanisms is the fact that they are forms of organized cooperation. However, they differ in a number of dimensions, and these differences can be important for their performance and their capacity to change and initiate reforms. For example, some are better able to make fast decisions, while others are more apt to reduce uncertainty and create stability. They also differ with regard to the groups and interests they include and exclude in the decision-making process.

Table 3.1 lists the main differences between the five types of economic governance. Except for the state, all governance mechanisms –

associations, networks, communities and the market – are 'private' and consist of self-governing bodies. However, the state often delegates tasks to associations and sometimes also to networks, thus making them some kind of semi-public entities. Given the quite different ways in which governance mechanisms function, it is important to keep their special features distinct from each other. Classifying them all as 'private' without pointing out their different capacities, for example to negotiate and implement reforms, would lead to a loss of important information.

The approach was originally designed for a closed economy and for analyzing how governance mechanisms change in a country when it is challenged from abroad, for example due to increased internationalization. When economic governance is applied at an international or global level, the category 'state' should become a supranational state, which still retains all the features described for a state but can also turn into a confederation of nation-states or a group of intergovernmental negotiators. It is the latter which poses problems for analysis. Is it indeed governance without government, since there is no supranational authority to steer, and since every state can back out at will in order to retain its national authority (see, for example, the IPE literature of Susan Strange)? Or is it a network of state agents who meet and negotiate as private agents do, with the state taking a new function as negotiator in the state-market condominium (see, for example, Underhill in this volume)? Or is it a new form of hybrid supranational state (Coleman and Porter 2000)?

Depending on the perspective taken in analysis, the issue of whose interests are represented and whose are left out will differ, as will the governance mechanism studied.

The table below distinguishes five economic governance mechanisms on the basis of sixteen criteria. All of these five mechanisms are somehow involved in financial governance, but to different degrees.

In order to analyze financial deregulation and re-regulatory reforms, especially those which aim for prudential finance (as opposed to reforms aiming to liberalize finance; see Coleman and Porter 2000), it seems important to highlight those characteristics which are significant for creating stability and trust, to highlight which governance mechanisms are more able to provide long-term stability, and to correct and prevent market failures related to long-term inefficiencies in the market (see Traxler and Unger 1994).

The *state* (Table 3.1, Column 2) is characterized by hierarchical control; it can give orders and acts through bureaucratic agencies. In addition to other functions, the state can use coercion in order to implement its policies. At the national level, central banks are an important institution representing the state in financial governance. When several states or central banks have to reach an intergovernmental

agreement or sign a treaty, they still have the power of coercion at the national level, but a global authority is still necessary for the hierarchical control of cross-border transactions. Since such an authority is often lacking in international relations, the literature on the international political economy was inclined to assume a withdrawal of the state (see Strange 1996). However, as Underhill convincingly shows in this volume, a more refined picture of the changed role of the state has to be drawn instead of leaving the state out of the analysis.

The state can delegate tasks to *interest associations* (Table 3.1, Column 3), which represent the interests of their members. Business associations represent firms and are often grouped by economic sector, while trade unions represent workers and employees. Groups with usually conflicting interests have to find compromises. Concertation is the dominant coordination principle. Interest associations are usually more familiar with specific complex issues than state agents, and they can also help to increase the acceptance of unpopular reforms among their members by developing convincing arguments. It is expertise and the mutual recognition of interests that make interest associations a powerful semi-public governance mechanism which often relieves the state of unpopular tasks (see Porter in this volume for a description of the role of associations in financial governance).

Networks can take many different forms, such as firms pooling their resources for joint research and innovation, supplier chains for production, or elite groups contacting each other occasionally. In global finance, such groups include networks of central bankers, for example. A common feature of all networks is that the dominant principle of coordination is reciprocity. The other participants have some resources (such as tacit knowledge) or intangible goods (such as connections) which make cooperation worthwhile (see Table 3.1, Column 4). Viewed from an actor-centered perspective, intergovernmental groups with supranational authority such as the G-20, which consists of finance ministers and central bankers from various countries, now also operate in the form of a network. These are networks of public policy organizations. Networks of private organizations (such as banking networks) and networks of public and private organizations are even more common today. The state now delegates tasks not only to associations but also to networks.

Communities such as families, tribes and clans are based on spontaneous solidarity as the coordination principle. Esteem and honor form the medium of exchange (see Table 3.1, Column 5). In particular, a lot of underground banking is governed by transnational networks. Eventually, these networks, which are unregulated and unchecked, were (and still are) used as a channel for money laundering and terrorist financing (see Unger et al. 2005).

A new form of community with increasing importance in a global world is that of epistemic communities (see van Waarden and Drahos 2002). An epistemic community is defined as a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue area (Haas 1992, p. 3, quoted in van Waarden and Drahos 2002). But epistemic communities are more than just networks. They share the same culture, the same norms and values, and the same symbols – the characteristics typical of a community. Epistemic communities consist of specialists and experts trained at the same universities and schools who share a common understanding of 'technical' matters to be resolved. They share a common world view (episteme) made up of the following:

1. a shared set of normative beliefs;
2. shared causal beliefs with regard to the linkage between policy actions and desired outcomes;
3. a consensual knowledge base built on shared notions of validity, that is, clear criteria for validating knowledge in their field;
4. a common set of practices associated with a set of problems to which their professional competence is directed (Haas 1992, p. 3, quoted in van Waarden and Drahos 2002).

The increasing complexity of fields such as finance amplifies the need for such specialists. This community functions as a channel of information exchange, learning and imitation, and as an important channel for the convergence of ideas.

The *market* (consisting of firms and buyers) or the political market (consisting of parties and voters) works through competition and uses money or votes as a medium of exchange (see Table 3.1, Column 6). Examples in global finance include international banks or the stock market.

The 'lubricant' which allows these five governance mechanisms to work is the predominant resource which they have and which distinguishes them from each other. While the state has legitimate control over the means of coercion, associations are institutionalized and recognized forms of representation of interests. In order for networks to function, it is the complementarity of resources that makes the other partners indispensable. Communities are based on trust and inherited status, whereas the market is based on calculative rationality.

For prudential financial reforms, an important factor is that these five governance mechanisms differ in their capacity to create regulations that reduce uncertainty. Van Waarden (2004) composes an ordinal scale of the capacity to reduce uncertainty in economic governance mechanisms;

the scale consists of the three organizational components listed under B in Table 3.1.

As one moves further from right to left in Table 3.1, that is, from the market toward the state, the governance mechanisms have a greater capacity for creating and maintaining more specific rules and regulations to reduce risk and uncertainty. This progression can be seen as an ordinal ranking from a weaker to a stronger capacity for reducing uncertainty (van Waarden 2004, p. 12).

With regard to the type of goods produced, only the market produces private goods, whereas all other economic governance mechanisms can produce some kind of collective (public) or club (semi-public) goods. The danger with networks (and depending on the type, also with associations) is that they might produce club goods only for their members and not produce (or possibly under-produce) public goods where one cannot exclude non-members from consumption. Financial stability is typically a public good where no one can be excluded from consumption. Therefore, it is important that the network members' benefits from the public good of prudential financial regulation are so large that they are willing to bear the costs of regulation on their own.

The advantages and disadvantages provided by each economic governance mechanism differ (see Table 3.1). Each governance mechanism excludes specific groups and people, and thus does not represent their interests. The state excludes people outside its territory. Associations very often tend to exclude the interests of non-members, in particular those of consumers. Financial associations deal with the interests of financial institutions, but not with those of the financial consumer (see Porter in this volume). Networks tend to forget about taxpayers, consumers and voters. The market allows everyone to participate, except those with no money.

The boundaries of who is in and who is out are clear for the state, the market and associations, but less so for networks and communities.

As a result, it should make a difference whether associations, networks or communities govern global finance. The public-private/state-market distinctions abstract too much from the differentiation of various private economic governance principles, which differ in communities, associations, networks and corporate hierarchies. And these differences have consequences for the interests served by policy and regulations. Governance mechanisms affect whether there is a symmetry (an egalitarian, public interest which serves all), or a particular bias in policy, in regulation, and in the rules that regulate international financial markets.

Table 3.1 Properties of different governance mechanisms

Criteria	State	Association	Network	Community/ Clan	Market
A. Coordination					
Dominant principle of coordination	Hierarchical control, orders	Inter- and intra-organizational concertation	Reciprocity	Spontaneous solidarity	Competition
Predominant collective actor	Bureaucratic agencies	Interest associations	Firms, elite groups	Families, tribes, etc.	Firms/ parties
Dominant medium of exchange	Coercion	Mutual recognition	Tacit knowledge, intangible goods	Esteem	Money/ votes
Predominant resources	Legitimate control over the means of coercion	Institutionalized forms of representation	Complementary resources (knowledge, know-how, goods)	Trust, inherited status	Calculative rationality
B. Organization					
Form of organization	Formal	Formal	Informal or formal	Informal	Informal
Form of organization	Vertical	Horizontal	Horizontal or vertical	Horizontal	Horizontal
Type of organization	Public	Private	Private	Private	Private

Table 3.1 (cont.)

Criteria	State	Association	Network	Community/ Clan	Market
C. Function					
Capacity to reduce uncertainty	Very high	High	Medium	Low	Very low
Type of goods	Collective goods	Club goods or collective goods	Club goods or collective goods	Collective goods	Private goods
Advantages	External security, equitable and predictable treatment	Less class exploitation, social peace, symmetric distribution of benefits, expertise	Flexibility, learning process possible, expertise	Mutual affection, collective identity	Material prosperity, efficient allocation, low transaction costs
Disadvantages	Government failure, bureaucracy, oligarchy of political leaders	Oligarchy of the peak of the association, exclusion of non-members, lack of transparency	Exclusion, tendency to form cartels	Inefficiency, nepotism	Market failures such as externalities, under-provision of collective goods
D. Inclusion/Exclusion					
Principal line of cleavage	Rulers vs. ruled	Members vs. association leaders	Club members vs. non-members	Natives vs. foreigners	Sellers vs. buyers
Groups excluded	People outside the state territory	Consumers	Taxpayers, consumers, voters	Foreigners, people not born within the community	Those without money. For the rest, individual property rights make participation possible.
Degree of inclusion	Very high	High	Low	Low	Very high
Clarity of boundaries	Clear	Clear	Vague	Vague	Clear

Source: Streeck and Schmitter (1985, pp. 5 and 9), Unger (1997, Chapter 5), Lütz (2003, p. 12) and van Waarden (2004, p. 12).

2.2 Blurred Distinction between Economic Governance Mechanisms

It therefore seems worthwhile to look at the debate on financial governance and to try to link it to the original economic governance literature. With regard to financial governance mechanisms, five categories of 'authorities' were identified in the literature (see Baker et al. 2005, p. 8):

- the nation-state;
- international multilateral institutions (IMF, World Bank, G-7, G-20, etc.) whose membership consists of states;
- trans-governmental regulatory networks (Basel Committee on Banking Supervision, International Organization of Securities Commissions) which are composed of national regulatory agencies working in a given specialist area of financial governance;
- regional regulatory cooperation (linked to regional financial spaces, EU);
- private authority, including but not reducible to 'the market' (private banks, industry associations such as the International Council of Securities Associations formed in 1988, which now constitutes a framework of rules governing global securities transactions).

These five 'authorities' have the (perceived) *right* to act and can exercise 'structural power' if they also have *the capacity* to act (Baker et al. 2005, p. 8).

If we compare these five mechanisms to the ones in the original economic governance debate, only the nation-state seems to have survived, but with declining importance.

Many financial governance approaches underline the weakening of the state through globalization (for an overview, see Grossman 2005, p. 130; Eising and Kohler-Koch 1994; Marks et al. 1996). Furthermore, they proclaim the structural power of finance, its hegemonic position within societal decision-making structures, and as a consequence the predominance of neo-liberalism.

The governance mechanisms of networks and communities have been diluted in various kinds of multilateral, trans-governmental and regional regulatory networks. In addition, by including not only firms but also associations, the governance mechanism of the market has been enlarged to the category of private authority.

Governance *of* finance, that is, the governance of the financial sector, and governance *by* finance due to the predominant role of the financial

sector in society (Hudson 2005, pp. 69f) both seem to display the characteristics of market governance or of network governance. The governance mechanisms of 'private authority' and 'networks' dominate the web of permanent interaction in multi-level governance.

Ironically, many of the multi-level governance approaches deal solely with formal public structures of authority. 'The study of multi-level governance has been hijacked by state centered approaches that have habitually conflated multi-level governance with multi-level government' (Baker et al. 2005, p. 15).

What has been lost in the financial governance debate is a clear distinction between types of governance. It has to be expected that the private authority of a 'bank' will behave differently from the private authority of an 'international association', and that the two will behave differently when they sit together in some form of network in order to negotiate securities matters. The distinction between the original types of governance is important for the speed and stability of reforms as well as for accountability, among other things. To give an example: an informal network will be more likely to carry out fast and radical reforms than an association. The latter is a formal organization which has to follow all kinds of procedures and is accountable to its members, whereas a network can form and dissolve easily and is only accountable to itself.

3. THE FINANCIAL GOVERNANCE DEBATE FROM AN ECONOMIC GOVERNANCE PERSPECTIVE

3.1 Governance in a 'State-Market Relationship'

In international relations approaches, there are basically only two opposing or concerting actors: the state and the private sector or the state and the market.

It is either argued that the state-market relationship has changed, that states have been rendered powerless by international capital flows, and that governance through market mechanisms dominates financial matters; or that the market has been missing in previous multi-level governance approaches, and that it was only about governance through governments (Baker et al. 2005).

Finally, the market seems to have dominated the debate on financial governance. The state has delegated a number of tasks to private bodies, which finally took over and led to a retreat of the state, as argued by Strange (1996). In the end, the state was once again lost in the debate.

Therefore, in a courageous attempt to bring the state back into the financial governance debate, Underhill created the concept of the state-market condominium. He argues against the dichotomy of state versus

market. 'The relationship (between market and state) is typically portrayed as one of interdependent antagonism, where public, political logic pulls one way and private, market-driven logic pulls the other. Such an image is rooted in the 19th century divorce between economics and the other social sciences' (Underhill and Zhang 2005, p. 6). Instead, 'the concept of the state-market condominium is proposed as an alternative approach, . . . states and markets are viewed as an integrated ensemble of governance . . . the central claim is that the state-market condominium is greater than its state-market parts and that the outcomes in terms of governance are significantly different from the preferences of either as identifiable agents' (Underhill and Zhang 2005, pp. 1f).

With this, Underhill also wants to stop the eternal debate on whether the market dominates the state or the state dominates the market, that is, whether there is a primacy of policy or not.

Underhill does so by making politics an endogenous variable. 'Different layers of political institutions can fulfill the "state" function over time, and we should not misconceive the identifiable institutional/organizational structures of the state as a phenomenon external to the dynamics of the market, in whichever form the latter may be found' (Underhill in this volume, p. 22).

Conceptually, in an actor-centered approach political agents and economic agents (i.e. individuals) meet in a condominium. Depending on their individual skills and power, one day the political agent may get a larger piece of the pie, or a larger 'bedroom in the condominium', and on another day the economic agent might get the larger bedroom. The political and the economic agents have become equal partners in the condominium negotiating game. One reacts to the other, they are interdependent, and they each have to pay part of the rent.

The great advantage of such an approach is that it demonstrates that politics reacts to economics and vice versa. It is a dynamic approach which shows that politics reacts to changes in the economy and vice versa, which again leads to changes in politics itself. However – and this seems to be the problem with this kind of approach – what then is the exogenous variable? It does not seem to be economics, and it no longer seems to be politics. But then who or what governs?

The actor-centered approach is reminiscent of economics, where utility-maximizing and profit-maximizing individuals meet at the marketplace to buy and sell. Friedrich von Hayek's old question of how they could know the market clearing price prior to their transaction, and how the market price could already include all information before the transaction has taken place, was resolved by simply assuming a simultaneous world. The question of whether the market price determines the quantities bought and sold or whether the quantities bought and sold determine the market price, hence the question of which is the exogenous

variable, went on for a while in economics and was answered in a pragmatic manner. Walras' model, which considers the price exogenous, eventually prevailed, but Menger's supply and demand schedule (*das Mengersche Kreuz*), which considers the price endogenous, is still the graph used to explain Walras' results. This is not only done to confuse students and to challenge the smart ones, but also because with the assumption of simultaneity it does not matter which variable comes first.

Who is the Walrasian auctioneer in IR or in IPE? If politics and economics are determined simultaneously, it does not matter which one comes first. It does not matter whether political interests or economic interests come first, nor does it make a difference which actor in the private sector has a say, whether it is a representative of firms, a representative of associations, or an actor in networks. They are all individuals engaging in some kind of interdependent financial negotiation game. Which actor has a say might only affect the outcome of the game, since some actors have more power than others and might negotiate a larger share of the condominium, but it does not affect the game itself. The condominium itself is exogenous, it is given, as are the preferences of the actors in the state-market bargaining condominium. The 'power' of the actors is reduced to the weight of their voices in the negotiation game.

Changes occur when power relations change or when preferences change. 'In such a model, change occurs simultaneously through the process of economic competition among firms on the one hand, and the policy and regulatory processes mediated by the institutions of the state on the other' (Underhill in this volume, p. 21).

But where is the Leviathan, the designer of the condominium, the one who shapes political preferences, and where is policy in this approach? The state-market condominium is a model that nests many different power constellations of markets and policy in financial governance. But it is indecisive in the crucial question of whether politics takes precedence over economics or vice versa. Hence, it does not help to explain the driving forces behind regulatory change.

3.2 The State as a Bargaining State

Globalization leads to an increase in the importance of 'technical' private authorities. The growth of technical and private authority has traditionally been legitimized by claims that these matters are not political and therefore do not need to be integrated into democratic processes. Hence, legal procedures are devised to safeguard the public interest, providing recourse for citizens who are the victims of technical errors. These procedures also seek to segregate technical or scientific matters from political questions. But this division between private and technical

matters and public policy concerns is becoming increasingly ambiguous (Coleman and Porter 2000, p. 387).

New supranational authorities are emerging. However, they are not focused on policy, but on technical matters. This technical character and the emphasis on procedures is typical of financial governance. With regard to prudential regulation, that is, rules that aim to limit the likelihood of financial firms' failure and to prevent financial crisis, the Basel Committee on Banking Supervision (BCBS) and similar committees based in the Bank for International Settlements (BIS) provide a flow of high-quality technical reports. Their analysis has clarified the nature of international financial risk. Their work has also contributed to developing recognized best practices for regulators responding to these risks (Coleman and Porter 2000, p. 391).

In 1999, the G-7 set up a BIS-based Financial Stability Forum consisting of 21 G-7 national representatives and 14 representatives from international public institutions concerned with regulation. This was followed by the creation of the G-20, which included finance ministers and central bank governors from key emerging markets. In this way, supranational authority at the global level has strengthened significantly in the area of prudential regulation in the last three decades (Coleman and Porter 2000, p. 392).

The perception of what a state can do has changed quite substantially (see also Weber in this volume, who describes the transition from the old interventionist state to the regulatory and then the competition state in finance).

According to March and Olsen (1989), the state can act and be modeled in four ways:

1. as a bargaining state, with emphasis on the state actors that negotiate;
2. as an institutional state, with emphasis on the courts and legal processes;
3. as a supermarket state which provides the most efficient services;
4. as a sovereign state which sets the political agenda.

In today's financial deregulation and reform analyses, the model of the state comes closest to the corporate-bargaining state, which has a stable, institutionalized political process and is characterized by a reduced role assigned to legislators, ideological parties and the public. Delegating authority to a network of boards and committees in which bureaucrats and organized interest groups are the main participants, focusing the political agenda on technical issues rather than ideological ones, ensuring a low level of conflict and placing emphasis on compromise are also typical (March and Olsen 1989, p. 113).

The advantage of this technical determinism is that political and economic institutions have time to adjust without losing time and resources in disputes over new goals and instruments. The disadvantage is that existing, perhaps superior, options are not even discussed. Policy, the element of design, and debate on political outcomes are lost.

The task of the sovereign state is to shape preferences, plans and visions of a 'good' society. Political discourse in such a state is more controversial and ideological, though common values are agreed upon. This means that economic policymaking options are also discussed in more detail. The disadvantage is that the implementation of new goals and instruments is more difficult due to more controversy than in a corporate-bargaining state.

The idea of a sovereign state is absent in global financial governance. Models either perceive a reduced role of the sovereign state, for example due to state competition (Weber in this volume) or the transition from a sovereign state to a bargaining state (Underhill in this volume). This poses the serious question of who then shapes preferences and governs ideas.

3.3 The Role of Networks and Associations is Unclear

The literature on IR and IPE does not differentiate systematically between networks and associations. While the former is more flexible, can be an informal relationship between several actors and is based on reciprocity, the latter is a formal institution based on representativity. On the one hand, almost everything seems to be some kind of network, on the other hand it does not matter whether this 'network' consists of state agents, of banks or of associations. This muddling of categories defines away the fact that state agents, bankers and associations face different organizational structures, different constraints, and that they have different goals and are accountable to a different degree and to different groups.

3.4 Need for More Precise Analysis of How Governance Mechanisms Function

What is lacking in all these approaches is a systematic separation of different types of governance and the search for the predominant governance mechanism. Is it the state, markets, networks, associations, or communities which govern global finance? Moreover, which typical patterns emerge? As long as the outcomes are a complex description of a complex reality, one cannot draw more general theoretical conclusions

than the fact that patterns change. Many of the approaches are descriptive rather than analytical and focus on the process rather than the content.

If the typology of private authorities' governance mechanisms is more precisely distinguished in IR and IPE, one may also find effects of regulatory financial reforms which van Waarden (2004) called 'communicating vessels'. Using various examples, he shows that in many cases it was not deregulatory reforms that brought about the governance mechanism of the market, but some other, unintentional kind of economic governance. Similarly, the deregulation of finance has led to prudential financial regulatory reforms. It would be important to analyze the underlying governance mechanisms in more detail, in particular the role of informal networks. For an example, see Lütz in this volume.

4. ASSESSING POLITICAL POWER

Mainstream international relations theory displays a deficiency in assessing the political power of the actors. In fact, global governance approaches, as some of the youngest theoretical approaches in international relations and the ones most open to attributing prominent political roles to non-state actors, have faced fervent criticism for initially assuming conflicts of power away (Fuchs, 2005, p. 1).

When the analysis concentrates on the way in which state actors negotiate with market actors in order to reach a joint outcome, some of the essence of power relations is lost. Following Lukes (1974), Fuchs (2005) argues that there are three faces of political power.

The first face of political power is instrumental power. Which influence do specific groups or actors have on political/policy output? In traditional power theories of international relations, the literature on lobbying, interest group politics and the use of power by states in pursuit of national interests deals with this kind of power. But this instrumentalist perspective fails to capture the potential influence that the dependence of the political elite on private-sector profitability has on political agendas and policy options.

Therefore, a second face – the structuralist perspective on power – has to be added. Why are some issues never on the agenda and some proposals never made? Who has the agenda-setting power? And who has the rule-setting power? In international political economy, it is frequently argued that multi-national corporations (MNCs) held increasing structural power due to their ability to punish or reward countries for their policy choices (Fuchs 2005, p. 5). This kind of power is difficult to assess empirically, since the threat to move funds away in the case of unfavorable policy does not even have to be voiced.

The acquisition of rule-setting power by non-state actors has become a focal point in the discussion of global (financial) governance and new forms of governance through 'private authorities'. The relative bargaining power of state and market actors depends on the specific distribution of assets and capabilities (see, for example, Underhill in this volume). But why are some proposals never made?

Even an analysis of both the instrumental and the structural facets of an actor's power still lacks the third face of power, the discursive perspective, the systemic conditions of power. In this perspective, power is exercised through norms and ideas. It is reflected in discourse, communication practices, and cultural values and institutions. 'Actors strategically use discourse to shape norms and ideas, for instance, by employing symbols and story-lines, and by the strategic linking of issues and actors to established norms and values. Discursive power precedes the formation and articulation of interests in the political process, due to its role in the constituting and framing of policies, actors, norms and ideas. An analysis of discursive power would consider the socialization of politicians and the public into accepting "truths" about desirable policies' (Fuchs 2005, p. 6). The role of media and public relations as well as the role of epistemic communities would have to be studied. But this third face of power is the most difficult to recognize and measure. It relies on persuasion, the perception of legitimacy, and voluntary compliance rather than coercion and hierarchies. It will often not even be perceived as an exercise of power and therefore not be questioned.

4.1 Is There Any Actor Who Governs?

An issue that also seems to have been lost in recent governance literature, including that on financial governance, is whether someone, some actor, individual or organization, actually governs, and if so, who that is. Who has the power in the end, and whose interests are being served (best)?

It is not surprising that this question has been lost in modern governance literature. The change in emphasis from 'government' (an identifiable actor) to 'governance' (a process), and from national policymaking (a level with identifiable actors) to 'multi-level governance' has made it unclear who is actually making policies, regulating and setting standards. And that is not unproblematic, because if we do not know who wields power, we also do not know who to hold accountable.

Many past theories have linked *policy and regulation* to *power* positions, and those in turn to *interests*. It has often been assumed that those in power will use that power to serve their own particularistic interests in the policies they pursue and the regulations they enact. Power and interests were thus closely linked to one another.

Economists have always started from the assumption of a close link between action/choice and self-interest. Thus the 'economic theory of regulation' (for a survey, see Underhill in this volume) argued that public policy output (i.e. regulation) was influenced by powerful lobbies, and that regulations thus served the particularistic interests of some at the cost of others, on the whole reducing economic efficiency and prosperity. Mancur Olson (1965) provided a logical argument as to why associational governance also does so: Small groups (e.g. concentrated industries such as the financial industry) find it easier to form strong associations than larger groups (e.g. consumers of financial services), and as the former have more powerful associations that lobby governments, they also succeed in obtaining regulation which is biased in their interest. If there is an asymmetry in the distribution of costs and benefits of regulation, it is likely that this regulation will be biased. Groups in which costs or benefits are concentrated (e.g. a concentrated steel industry that profits from protectionism) have a stronger incentive to lobby governments to serve their interests than those groups over which the consequential costs or benefits are diffused. Therefore, the banking industry profits greatly from vague financial product information requirements, while the costs (i.e. misinformation) are spread over a large group of consumers of financial services, for whom this is a relatively minor concern. This means that they have less of an incentive to organize and mobilize against such regulation. All such economic theories of regulation assume that most regulation will be influenced by the more powerful actors and will therefore be biased toward their interests (see also Rothschild 1971).

In political science, we can see a similar concern. From the 1950s to the early 1980s, political scientists were concerned with the question of 'who governs' (see, for example, the famous title of the classic work by political scientist Robert Dahl [1961]). Dissatisfied with the formal institutionalism of the 1920s and 1930s – which located political power where the formal institutions laid it: with ministers, judges and members of parliament – the political scientists of the 1950s tried to identify who 'really wields power' (for an early example, see Lynd and Lynd 1937). Thus a whole series of studies on local political communities tried to identify the real power holders in those communities through a variety of empirical techniques: not the mayor, but the big industrialist or the head of the local church (e.g. Lasswell and Kaplan 1950, Polsby 1963, Lundberg 1937, Schattschneider 1960; international: Kolko 1962). This was followed in the 1970s by a series of studies focusing on economic power, including studies which tried to identify indirect and underlying political power: the power to set political agendas, to prevent issues from being placed on the agenda or, conversely, to place them on the agenda (Bachrach and Baratz 1970).

All these studies in economics and political science from the 1950s to the 1980s share a concern with the issue of 'who governs', who has power, and subsequently whose interests are served by government measures. This knowledge-guiding interest seems to have disappeared with the change in discourse from 'government' to 'governance'. It would be a good idea to put it back on the research agenda.

4.2 Bringing Power Back

Tsingou (2005) argues that the policies that make up global financial governance are accepted as legitimate primarily due to the high level of expertise involved in the policy process. But, as she also states, this does not automatically legitimize the policy priorities chosen. The answer to the question of who governs must include not only a description of who serves on which committees, but also an analysis of who governs and why specific political priorities are set and followed.

In most countries, finance remains an 'esoteric' topic with few or no publicly debated issues (Grossman 2005, p. 131, quoting Coleman 1996, pp. 9–10). The question of who governs is addressed to a lesser extent. This article is merely an attempt to put the issue back on the research agenda. I cannot answer it yet, but I can outline some literature and some theoretical approaches which claim to have some answers to this question.

Coincidence: Is it coincidence – that is, the unintentional outcome of some actors negotiating with each other – which governs, and, depending on their individual skills of diplomacy and negotiation as well as their relative power, which makes one outcome more likely once and another outcome more likely the next time?

March (1994), when analyzing 'How Decisions Happen', stresses the role of accident. Many decisions are unplanned. In his 'garbage can' model of decision-making, he shows that the logic in decisions has a temporal order: Who was at the right place at the right time when decisions were taken, and under which contingencies (external threats, emergencies or incidents) were these decisions made?

It seems quite convincing that policy is the outcome of some muddling or interdependence between the economic and the political sectors, or of the coincidental skill of some convincing negotiator or strategist, etc. However, if this is the case – if policy is only an incidental outcome of negotiations – how is it possible that neo-liberal politics have been predominant and unanimously proclaimed almost everywhere since the mid-1980s? Newspapers, politicians and even academics have become neo-liberal.

Optimality: Neoclassical economics would interpret the worldwide convergence toward market-friendly policies as the growing insight into

reason: Neo-liberal policies are considered optimal approaches to fostering economic prosperity, so any other policies are either not feasible or lead to inferior outcomes. The failures of neo-liberal policies in practice are attributed to faulty implementation, not concepts.

Structural forces: Structuralist approaches in a Marxist tradition interpret the switch from Keynesianism to Neo-liberalism and the growing role of finance in politics and economics as a result of the changing needs of capital, induced by changes in the forces of production. In this account, politics is seen as by and large determined by economic developments (Duménil and Lévy 2004). This is typically rejected in political science, which insists on the existence of a specificity of the political domain.

Conspiracy approaches assume that there is some secret, centrally directed strategic action to serve the interests of a small group of powerful people. In finance, popular literature on the Bilderberger organization (Fosar and Bludorf 2005), for example, sees this group consisting of nobility, bankers, politicians and businessmen as 'the high priests of globalization' and as the political career makers since World War II. According to this literature, this group planned the liberalization of trade and capital and strives to establish a single World Central Bank. The existence of secrecy and conspiracy is impossible to evaluate using scientific methods.

Recent articles in academic literature include that of Fuchs (2005), who gives some empirical evidence that MNCs strategically plan to shape ideas, to capture politics and to be present in the media. In international finance, Harmes (1998) argues that institutional investors deliberately worked to reproduce neo-liberalism by threatening governments, the threat being to withdraw money.

Hegemony, a concept which goes back to the Italian communist leader Antonio Gramsci, also believes in some kind of conspiracy, but it does not necessarily assume coordinated strategic action to serve the interests of the powerful. There is some leadership or dominance of one group over others. The more powerful class has the ability to persuade other classes to see the world in terms favorable to its own ascendancy. Hegemony is a ruling class's domination of subordinate classes through the elaboration and penetration of ideology in their common sense and everyday practice. It is the systematic, albeit not necessarily deliberate, engineering of mass consent to the established order (see www.caledonia.org.uk/hegemony.htm). Epistemic communities can be an important tool for financial hegemony, which does not govern through coercion but through ideology (cf. Gill 1998).

Epistemic community governance does not assume coordinated strategic action, but actors make similar choices on the basis of belonging to the same community, defined by a body of knowledge (episteme). This

body of knowledge can be derived from an academic discipline and joint socialization in it (law, engineering, scientific medicine, economics, or sub-disciplines like mainstream neo-classical economics), or from joint socialization in a belief system (Catholicism, Islam, esoterics); or it can be derived from shared task contingencies such as air traffic controllers' need to ensure the safety of airplanes. In finance the shared task could be to safeguard the value of money and keep inflation low. This usually shows up in shared (though not explicitly coordinated) perceptions of problems and shared perceptions of acceptable and appropriate solutions (cf. Markussen 2000).

In finance, it is argued that the influence of elite groups, bankers, the lobbies of leading financial firms and the Wall Street Treasury complex in pursuit of their own interests has increased (Soederberg 2005). 'The regime for prudential regulation has been developed by central bankers from different states. These actors commonly share a world view based on established central banking practices such as secrecy, an aversion to political interference, and a commitment to the primacy of economic and technical knowledge in decision making' (Coleman and Porter 2000, p. 392).

Bankers form an epistemic community; they have the same education and similar working conditions, thus they perceive similar problems that have to be solved and are important. As they attended similar schools and universities, they also share similar ideas of how to solve those problems. They share the same symbols, such as dressing in similar ways and driving similar cars. They exchange information informally in golf clubs, while hunting, etc. All this adds to the development of common ideas and world visions. Furthermore, there are numerous networks of the political elite, such as the World Economic Forum or Bilderberger, a group formed around J.D. Rockefeller in 1954. These networks also add to the shaping of joint values and ideas.

Networks of the elite play an important role in global financial governance. In particular, this is because they have a relatively homogenous political perception of how the global financial world should be.

In this way, they exclude specific interest groups such as consumers or African countries, which do not appear on the maps of the international financial community but are considered the suppliers of raw materials and the recipients of foreign aid. These groups do not have the same opportunities to form networks or epistemic communities. They receive their world vision from the newspapers and television, which corresponds to the view of the experts. As Fuchs (2005) states, there is an increased number of private businessmen figuring as experts on economic issues and spreading neo-liberal ideas in television and the media.

Imitating theory: Following fashions, jumping on the bandwagon, or behaving like lemmings might also explain the bias toward neo-liberalism. If one actor imitates another, and if efficiency and the lean state become fashionable ideas, herd behavior might explain the outcome. The rise of herd behavior among institutional investors, their tendency to ignore economic fundamentals (relying instead on technical analysis and newspapers, and therefore buying and selling on the basis of asset prices only) and to follow the behavior of others, can be mentioned here (Harmes 1998, p. 102). Also, deregulation itself can become a fashion where one public sector, country or community copies another.

It is most likely that some combination of the above-mentioned factors determines who governs. Finance does share the same values, partly because it belongs to the same epistemic community. But it can also organize much better at the international level than consumers or workers. Labor and consumers have not (or only barely) managed to organize at the transnational level. The world vision is transported by the press and by television, which convey the neo-liberal ideas of technical experts from epistemic communities. It may be coincidence, or maybe these groups are better organized and know what their interests are. And, even without communicating it, this has been able to make neo-liberal ideas so popular today. In addition, internationally mobile finance can exert powerful economic pressure on politics, which can foster its success in attaining the policies most suitable to its interests.

Finally, the question emerges whether finance automatically has to be neo-liberal. Could it be that in the long run an excessive redistribution between the financial and the real sector will hollow out the income of finance itself? A balance between the interests of the financial and real sector seems necessary for the long-term survival of both parts.

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