Reflexivity in Global Finance: How Agency Matters to Market Change
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ABSTRACT

Many scholars of finance have emphasised the importance of agency in bringing about structural market changes. However, where much of this work has been strong on the empirics, it has often worked inductively and left open more general questions: how analysts should think about this agency in the first place? Where should they look for it, and why?

This paper argues three points: First, in addition to public actors, it identifies financial services firms themselves as core actors in what one could call 'agency through rule change'. At the same time, the concentration of global financial markets ensures that market participants affect overall market structures through 'agency as market behaviour'. Second, this agency is characterised by 'reflexivity' that constantly confronts agents with the intended and unintended results of their own actions. Third, the structurational approach to studying finance that these two arguments suggest can lead to fruitful and empirically grounded theorizing through innovative use of the comparative method.

The relevance of agency and reflexivity for financial market evolution are illustrated using two core developments in global financial markets of the last decades: widespread market liberalisation and EU financial market integration, the most daring instance of transnational integration thus far.

Keywords: globalization, financial markets, liberalisation, structuration, reflexivity

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INTRODUCTION

The evolution of global financial markets (GFMs)—indeed, their globalisation itself—is widely acknowledged as a driving force behind changes in of the global political economy at large. Understanding politico-economic change in general therefore requires an understanding of financial market transformation itself. How and why has it come about?

As Helleiner (1994) has pointed out, governments have played a central role. His historical account—and others pointing in a similar direction—have offered valuable empirical insights. But they have had less to say about how scholars should think about agency in financial market change in the first place. When trying to understand change, where is the right place to look, and why?

This paper argues three main points: first, agency matters to financial market change in a two ways that are not reducible to structural or institutional dynamics: agency as rule change and agency as market behaviour. Second, this centrality of agency generates a 'reflexivity' (Beck et al. 1994) in financial market change that has thus far received little scholarly attention. Through the (often unintentional) ways in which they affect market structures, regulatory reforms and market strategies create their own policy and business challenges. Third, the structurational approach to studying finance (Cerny 2000) suggested by these two points can be made fruitful for empirically grounded theorizing. The constituent elements of structuration dynamics can be systematically compared across a wide range of variables: countries, time periods, sectors, firms, reform initiatives, international institutional settings, etc. A structurational approach is thus not confined to abstract theorizing. In fact, it generates a more realistic image of market development by emphasizing the contingency of the different factors contributing to it rather than reifying them.

The next two sections of this paper present the first two arguments. Section four empirically illustrates how they matter to two recent developments. Financial market liberalisation and EU financial market integration. Section five uses a structurational model of financial market change to suggest how future research might make more room for agency and reflexivity without loosing rigor and theoretical leverage.

HOW AGENCY MATTERS IN FINANCIAL GLOBALISATION

GFMs have often been conceptualized as a 'structure' that public and private agents face and that constrains their actions. These constraints, so the argument, are sufficient to promote globalisation in general—both in economic activity and the 'globalisation' of the state (see Clark 1999, Cameron and Palan 2004). Once capital is mobile, regulatory competition forces change in financial market policy (Laurence 2001). Alternatively, capital mobility transforms domestic politics by changing social groups' preferences and power resources (Frieden 1991, Keohane and Milner 1996). The globalisation of financial markets itself remains unaccounted for and is treated as an exogenous factor, however.

In the most basic sense, the 'structures' public and private actors confront in GFMs are patterns of behaviour of other actors. Asking how GFMs constrain individual agents is asking how agents in GFMs constrain each other. Inquiries into the structural properties of financial markets focus on interaction patterns, how they arise and why they change. Structures are analytical abstractions of these patterns, but they have little explanatory power in and of themselves.

Capital mobility is a point in case. Much scholarship reifies it in the sense that

> it is treated as an object analytically independent of the actions by which it is produced. (Maynard and Wilson 1980: 287)

Rather than a 'thing' out there, the ease with which capital can move across borders (capital mobility literally understood) is the result of politically inspired reforms that include exchange and credit controls, financial regulation and taxation regimes. This makes capital mobility not only hard to define and measure (Eichengreen 2001). It also cautions against using it as an 'independent' variable explaining other developments in financial markets, for example their liberalisation (Laurence 2001). The mobility of capital is as much a result of financial liberalisation as it is its cause.

Other IPE scholars have instead focused on agency in global financial change and the role of government policy in 'the re-emergence of global finance' (Helleiner 1994). They have analysed financial services reform in core OECD countries (Moran 1991, Coleman 1996, Lütz 2002), EU financial market integration (Underhill 1997) and international agreements in the domain (Filipovic 1997, Baker 2005, Wood 2005).

Most of this work has been inductive. Authors have rarely justified their focus on agency in theoretical terms. Why is it not enough to treat the structural properties of the global economy as in the end sufficient to explain market evolution? Indeed, the case for agency-centric work is strong. The argument that change at the structural level (i.e., in GFMs) can only be understood with reference to a variety of agents has two components. In 'agency through rule change' public and private actors alter financial market rules and thereby change the markets themselves. 'Agency through business practice' applies to market participants themselves, mainly to financial services providers but also to governments and non-financial corporations. In contrast to beliefs about the anonymity of global finance, these markets are so concentrated that the biggest market participants constitute them simply by the way they operate. And the way the conduct of large financial firms shapes these markets follows a *commercial* logic operating at the level of the firm rather than *systemic* logic of financial markets as a whole.

Agency as rule change

Markets do not spring up naturally. They need institutions to support them (O. Williamson 1987, Fligstein 2001, Swedberg 2003). With financial markets, that point was famously made by Vogel (1996). Regulations and licensing regimes that define who can do what where under which conditions are the most important institutions that underpin financial markets. Indeed, because of their immaterial quality, financial markets are 'regulation-defined' (Vietor 1987)—more so than sectors dealing in tangible commodities.

Policy communities are inhabited by a wide variety of actors – central banks, finance ministries, regulatory agencies, self-regulatory organizations, financial services providers (banks, for example), etc. (Coleman 1996, Lütz 2002). Public actors are undisputed as important contributors to policy, but also the role of private actors has been increasingly recognized over the years (e.g. Underhill 2001). Why do these actors push regulation – and financial markets with it – in particular directions?

The first thing to note is that actors care about different aspects of regulation. Central banks worry about financial stability and the impact of regulation on their own activities, particularly monetary policy. Regulatory agencies are concerned with investor protection. Finance ministries use financial markets to achieve wider policy goals (e.g. industrial policy, channelling credit and the provision of venture capital). In addition, governments are financial market giants themselves, with a gross issuance of trillions of Dollars of debt every year.

Retail investors (should) care about their own protection. Wholesale investors worry about market liquidity, the availability of capital and cheap financial services. Financial services providers themselves, finally, care about profits and their competitive position.

Regulation is no struggle between two camps (the state versus the market, say) where the relative strength of the parties determines where on a continuum between two antagonistic ideals the actual policy outcome lies. Such an imagery neglects the complexity of interests involved (Clarke 2000). Rather, the plurality of actors' interests means that financial market reform needs to be studied bottom-up. It cannot be reduced to simple, quasi-structural mechanisms.

Although the background and interests of actors in policy communities vary widely, the number of significant actors is small—both in domestic and international forums. On the public side, less than a dozen countries dominate international organizations such as the Basle Committee on Banking Supervision (BCBS) and the International Organization of Securities Commissions (IOSCO). Among these countries, the US is the primus inter pares (Simmons 2001). In the European Union, consensus among Germany, France and the United Kingdom is the central condition for Union-wide agreement in financial market policy. The concentration of capital market activity in few countries allows forms of policy coordination at odds with theories of regulatory competition (Esty and Geradin 2001). Indeed, empirical studies of both international and European financial services markets found no evidence of regulatory competition (Hertig 2001, Trachtman 2001).

On the private side, the producers of financial services overshadow other stakeholders such as institutional and retail investors and issuers of financial instruments (Kroszner and Strahan 1999, Hardy 2006). Actors with a stake in market efficiency have little sway over policy, quite in contrast to those eager to exploit market imperfections. In addition, producers in the financial sector increasingly act as rule-setters in the transnational domain and strongly lobby international organisations on rules set through the latter (e.g. Grossman 2004; Mügge 2006b).

Agency as rule change is exerted through political institutions that are neither reducible to structural imperatives (Cerny 1990: 9ff) nor to the immediate interests of the actors that they bring together (Krasner 1984, Skocpol 1985, Ikenberry 1988). This notion has become popular as 'historical institutionalism' (Pierson 2000a, 2000b). Obviously, institutions do not do anything themselves. They merely act as a filter for the efforts of agents to affect market rules. Nevertheless, through the way they canalize agency as rule change, political institutions deflect what structuralist theorists would consider market imperatives. If nothing else, agents are faced with *two* sets of structures—market structures and political structures—that need not guide them in the same direction. This incongruence that many historical institutionalists in comparative political economy have carved out precludes structuralist reductionism. Instead, it necessitates micro-analyses of how agents balance between the two in their efforts to mould market rules.

Agency as business practice: the importance of market concentration

The concentration of business in wholesale capital markets is remarkable. Industry figures dispel the myth that finance approximates orthodox economists' ideals of 'markets' – or, to be more precise, that markets for financial *services* do. Underwriting in both equities and bonds is instructive. Throughout the 1990s, the top five firms captured between 44 per cent and 50 per cent of combined *global* debt and equity underwriting (Group of Ten 2001: 56f). US firms have dominated this industry, also outside their traditional home market. By 2000, it was estimated, the US investment banks had captured 70 per cent of fee-income on 'European capital markets and corporate finance transactions' (Smith and Walter 2003: 367).

In global terms, the United States was and is the most important capital market.[1] Looking at its stock market alone, US equities' market capitalization as a share of global market capitalization rose from 32.7 per cent in 1990 to 49.1 per cent in 1998 (Smith and Walter 2003: 148). The 'bulge bracket' firms have enjoyed a firm grip on these markets for decades (Augar 2005). In US initial public offerings (IPOs), the three top firms, Merrill Lynch, Morgan Stanley and Goldman Sachs, have captured more than 50 per cent of the market among the three of them (Group of Ten 2001: 454f).

European markets have also been heavily concentrated throughout the previous decade (European Commission 2005: III-2ff). In 1995, the top-20 underwriters had no less than 98.9 per cent market share (Cabral et al. 2002: 27, see also Santos and Tsatsaronis 2003). In 2000, the top-20 still had almost 95 per cent of the market. Underwriting is concentrated

[1] Most of the figures in the coming paragraphs focus on the EU and the US. They are used because the EU and the US are the most important capital markets and within the OECD world—which this paper mainly focuses on—these two regions are of primary concern to most scholars.

geographically, too. 85 per cent of non-government bonds in Europe are underwritten and traded in London (Casey and Lannoo 2005: 34). Equity underwriting shows a roughly similar, if less pronounced picture. In 2001, the top 10 firms had more than 83 per cent market share (Cabral et al. 2002: 28). ‘Globalizing’ capital markets have not ‘evaporated’ into anonymous cyber-space. They have become dominated by a handful of globally operating firms.

This concentration has two consequences. First, the way top financial institutions develop their business is at the core of how ‘global finance’ develops (cf. Goldstein 1995). Michael Milken of Drexel Burnham Lambert single-handedly introduced ‘junk bonds’ on Wall Street in the late 1980s. Another group of investment banks pioneered complex derivatives around 1990 and thus opened up the avenue towards structured finance (Partnoy 2002). The most innovative banks are at the forefront of the private equity wave that has reached continental Europe in the recent years (Saigol 2004). All three—junk bonds, complex derivatives and private equity transactions—have played a central role in corporate governance and restructuring in the recent decades, first in the US, then in the UK and now also in continental Europe.

What these developments have in common is that they are driven by a *commercial* rationale operating at the level of the *firm*, and not by *system*-level imperatives (for example efficiency). New financial products have been introduced when they made business sense for the producer. Commodification of financial services invites competition and drives down prices. The commercial objective of firms, in contrast, is to counter the market mechanism’s potential of eroding profits. To understand how financial markets evolve at their cutting edge one needs to comprehend the banks’ perspective on future business opportunities.

Second, these firms can interact strategically, not just parametrically (on the distinction, see Abell 2003). Top firms can affect overall market structures through their own behaviour, and they can coordinate such behaviour with others. For example, the US IPO cartel that managed to keep fees at 7 per cent for years. Broking firms and fund managers colluded in the recent US mutual fund scandal. And members of the world’s largest exchanges (e.g. the New York Stock Exchange) could until recently still set their own rules through self-regulation. In fact, the number of market participants is sufficiently small for social control over firms’ conduct in finance (Abolafia 2001).

From agency to structuration

Although the case for agent-centric research in financial market change is strong, it cannot answer all questions. As pointed out, most work mentioned above approaches financial market change inductively rather than being rooted in any particular theoretical approach. It has greatly enhanced our insight into the cases it discusses. Yet it has not readily lent itself to generalizations for general theories of financial market transformation or conceptual frameworks in which the different contributions could be blended into a larger whole. Just as approaches using structural properties of GFMs as explanatory variables had 'bracketed' agency, most agent-centric studies take actors' interests and identities as given. That is legitimate as a heuristic device but gives these studies an ad hoc-quality.

As leading scholars have emphasized, the next step for research is to systematically integrate both structure- and agent-centric approaches to financial globalisation (Cerny 1993, Helleiner 1994). In social theory, this social-scientific perspective has been called 'structuration' (Giddens 1984). It has been applied to International Relations (Wendt 1987) and been suggested for studying globalisation in general (Hobson and Ramesh 2002).

Although these suggestions have been strong on the side of social theory, they have remained unclear on (1) what these proposals would mean for the way we think about continuity and change in global finance, (2) what their value-added could be for understanding core empirical transformations in global finance in the last decades, and (3) how they could be moulded into a general conceptual framework that would be fruitful for future research. The remainder of this paper offer suggestions on these three points.

DOUBLE REFLEXIVITY IN GLOBAL FINANCE

Core agents in the global political economy shape GFMs through rule changes and their own business behaviour. Therefore, structuration in global finance is not only a matter of actors' 'constituting' global markets, with their actions unintentionally generating a patterned whole. Rather, core agents' *consciously* attempt to generate structural changes and are then confronted with the results. How can this feedback loop be characterized?

A structuration perspective on global financial change highlights a property that has thus far received little attention: reflexivity. This section argues that a 'double reflexivity' is at work in global finance—a combination of 'governance reflexivity' and 'market reflexivity'.

Reflexivity—a concept central to Beck's theory of reflexive modernisation (Beck et al. 1994)—refers to the fact agents are confronted with the results of earlier actions. These consequences, theorists of reflexivity argue, often differ from the intended ones. Societies are complex and bring together myriad agents with different agendas, capability and perspectives. The outcome of their interactions is beyond the grasp of any individual agent, also because of the 'independent' effects of institutions (Pierson 2000a). It is therefore liable to generate new agency and inject dynamism into social change.

Reflexivity means that the way agency affects market structures is unpredictable, both for analysts and agents themselves. To be clear, the point is not that actors cannot achieve their goals. They often will. But in passing, they will generate side effects that they had not foreseen. These side effects are a structural feature of financial market change that has hitherto largely been dismissed as 'noise' in processes of market evolution. Instead, this paper argues, structural change should be analysed and theorized as a combination of intended and unintended consequences of purposeful agency. Reflexivity as a property of social change cautions against excessive reliance on backwards reasoning. One cannot read the input into a political process—including the relative influence of various agents—off its result. The following two subsections will detail this point for agency as rule change and agency as business practice before showing how both are related.

Governance reflexivity

Governance reflexivity refers to the reflexivity inherent in the process of setting collectively binding rules. Actors change rules, rules change market structures, and structural changes spur agents to push for further rule changes. In a nutshell, financial market policy generates its own future policy challenges. Admitting new financial instruments to trading may generate financial fraud or instability. Defragmenting the financial services sector may promote over-concentration in the industry that requires further policy measures. Introducing interest-rate ceilings may promote excessive capital outflows, abolishing them may lead to bankruptcy of hitherto protected financial firms, requiring further policy solutions. The list could easily be extended.

Governance reflexivity is particularly acute in financial markets because these markets are complex and evolve rapidly. Regulators and supervisors can barely keep up with financial institutions, let alone stay on top of developments (McKenzie and Khalidi 1996). For example, traded volumes in the young market for credit derivatives multiply every year. The implications for financial system stability and the viability of large financial institutions remain in the dark. Precisely at the cutting edge of financial market developments, policy depends on guess-work – in spite of high finance' tendency to present itself as a very orderly affair, amendable to scientific treatment (de Goede 2001).

Recurrent financial crises show how policy always stays one step behind market developments (Kapstein 1992). Ironically, also in financial crises, the solutions to a problem may be the root of its future twin. Washington Consensus-style reforms were to set the wrongs of Latin American finance after the 1980s debt crisis right. Yet the solutions generated their own wave of crises in the region and other emerging markets in the 1990s. Monetary easing in the US after the deflation of the stock market bubble, meant to ameliorate the threat of economic recession, has fuelled the next bubble waiting to burst—this time in real estate. Again, the list could easily be continued.

Governance reflexivity also applies to rule changes market participants use to further their own objectives. Two variants are common: first, agents may initiate regulatory reform that spirals out of control and produces results different from those intended. Second, the reforms may approximate what agents had intended but their effects on markets may be different. Examples of both variants will be discussed in the following section.

Market reflexivity

Reflexivity in global financial markets has been popularized by George Soros (1998). His concern was different than the one discussed here: market developments, he found, depend on the beliefs of market practitioners about them. Unless the recursiveness between financial markets and peoples' views about them was acknowledged by policy makers and practitioners, he argued, markets would remain crisis-prone.

Market reflexivity as understood here goes in a similar direction but has a different emphasis. Many market participants—including, as he readily admits, George Soros himself—are perfectly aware of this recursiveness. And they try to exploit it. Soros' own attack on the Pound Sterling in 1992 is a prime example (Krugman 2000: 121ff). Manipulating markets meant manipulating expectations. The quintessence of market reflexivity is not that market participants could not be aware of this recursiveness. Rather, the question is whether this awareness helps them to avoid unintended consequences of their own actions. The complexity of financial markets (Mandelbrot and Hudson 2004) ensures that that remains impossible.

Market reflexivity operates not only in firms' behaviour in markets themselves (e.g. in trading bonds or shares, where Mandelbrot and Hudson have provided ample evidence) but also in general business strategies. In wholesale capital markets most profits can be earned with complex, innovative products. Business strategies that focus on innovation have a self-defeating potential, however. They invite emulation by competitors and thereby erode initial advantages. Then again, that need not be the case. Latecomers can free ride on others' innovations, but their emulation strategies may still fail as these firms lack the first-mover advantage (the rush of German universal banks into investment banking is an example, see Jenkins 2004). The market for complex derivatives illustrates how that has led investment banks to continuously reinvent themselves and their business strategies (Partnoy 2002). In the case of Goldman Sachs, the most revered investment bank, observers have doubted whether the label 'investment bank' is still appropriate given the business it conducts to generate its profits (*The Economist* 2006). Firms cannot predict how other market participants react to their own innovation and what future strategy modifications may therefore be required. Just as policy solutions generate new policy challenges, new business strategies generate their own business challenges. Mirroring policy making, new business strategies mostly address problems of the past, not challenges of the future. The unexpected demise of seasoned institutions in the City over the past two decades (Augar 2000) or the dramatic rise of Japanese banks before 1990 and their equally dramatic fall after that illustrate the unpredictability market reflexivity generates.

Double reflexivity

Governance reflexivity and market reflexivity encourage a focus on how and why actors attempt to change market rules or how their market behaviour may change market structures, and how the structural consequences of this agency feed back into further actions. The key are the agents because their behaviour depends on how they evaluate opportunities and threats to the realization of their interests.

In attempts to attain their objectives—earning profits, satisfying voters, privatizing state-owned enterprises or raising capital cheaply—actors will use both kinds of agency if possible. Core agents will try to optimize their market strategies and simultaneously try to tilt market rules to their own advantage. For those agents who are capable to effecting structural changes in financial markets, agency as rule change and agency as business practice are two sides of one integrated strategy. Firms eager to expand abroad or into other sectors push for the abolition of inter-national or inter-sector barriers while developing their business accordingly. European financial integration, discussed below, shows this two-pronged approach at work. Governments also adapt financial market rules to suit their own interests as market participants. They may lower barriers to capital inflows to decrease the borrowing costs or promote domestic equity markets in preparation for privatizations.

This unity of rule-setting and market behaviour returns in the reflexivity itself. Agents use rule changes to address unintended side-effects of market behaviour and adapt market behaviour to the unintended side-effects of attempted rule changes. Put simply, market reflexivity feeds into governance, and governance reflexivity feeds into market behaviour. This double reflexivity is visualized in *Fig. 1*.

[*Figure 1 about here (see annex)*]

EMPIRICAL CASES: AGENCY AND DOUBLE REFLEXIVITY AT WORK

This section reassesses central developments in financial globalisation, in particular widespread 'liberalisation' and the attempts to create a single financial market in Europe, the boldest effort at transnational market integration thus far. The reassessment of financial liberalisation will illustrate the importance of agency rather than structural properties of GFMs such as capital mobility. The agency of firms is key both to the evolution of market rules and to patterns of market interactions. The creation of a single European capital market shows how agency generates unintended results. It is a good example of double reflexivity.

Financial liberalisation

In the dominant narrative of financial globalisation, the liberalisation and transnational integration of financial markets are flipsides of each other. Once national financial markets are relieved of their shackles and thus 'freed' (*liberalised* literally understood), they follow their inert drive to integrate transnationally. Transnational integration, in turn, forces governments to liberalize further, particularly through regulatory competition (see Clark 1999).

Even if not incorrect, this view conceals core aspects of how global financial markets change, and why they do so. Agency as rule change and agency as market behaviour have mattered decisively—and financial firms themselves have been central to both.

Financial liberalisation is a much more ambiguous concept that public debates commonly suggest. Depending on politico-economic faith, it can mean laissez-faire deregulation or competition-enhancing re-regulation (Vogel 1996). Empirically, however, one common and prominent element of financial reforms in the recent decades has been the loosening the restrictions on access of domestic financial markets (see J. Williamson and Mahar 1998).

Domestically, 'liberalisation' in this sense has meant breaking down barriers between financial sub-sectors, particularly credit business and investment banking. As Sobel (1994) has shown, these reforms were the result of struggles between service providers over access to the most lucrative financial market segments. They were a function of firms' skill in building political alliances to break cartels or protect them. Another aspect of domestic liberalisation—scrapping prohibitions on inter-state branching in the US—equally was a result of expansion-oriented banks lobbying for opportunities to enlarge their markets (Kroszner and Strahan 1999). Governments did not introduce competition to accommodate 'global pressures' or optimize public policy. They effectively acted at the behest of powerful firms.

Internationally, most work on 'liberalisation as providing free market entry' has been comparative (Vogel 1996, Laurence 2001, Lütz 2002). Analysts have overlooked that market-opening has often been mutually agreed. Governments did not simply 'abandon' the financial services industry when they opened markets. They often secured something for domestic firms in return: market access elsewhere. The creation of a single capital market in Europe followed this pattern (Mügge 2006a). Similar arguments have been advanced about financial market opening elsewhere, for example on the Pacific rim (Pauly 1988).

Both of these cases—Europe and the Pacific rim—highlight a second fault of much comparative work: it neglects the vast differences between the units that are being compared. Market opening has to be judged in light of its actual impact. Allowing foreign competition is very different for a country with a highly competitive industry than for one that is backward and ailing. Opening Wall Street to foreign firms is completely different than opening the financial services sector of, say, southern European countries. In spite of decades of openness only two foreign banks have been successful on Wall Street—Deutsche Bank and Credit Suisse. And both owe their success to major acquisitions. Because American firms were always capable of competing effectively, the potential industry costs of liberalisation were small.

The situation in countries with less developed financial services industries is different. In southern Europe, for example, local firms had—and have—much to loose from foreign competition. Accordingly, resistance to opening up markets was higher. In cases where the domestic industry was less fully developed—for example in most central and eastern European countries after the transition—opposition was weaker. More and quicker 'liberalisation' was the result. Treating these cases as though they were readily comparable misses not only core aspects of liberalisation politics. It also ignores how reforms in one country are actually related to those in others.

None of this will surprise the attentive observer. That protectionism can get in the way of liberalisation is a common complaint of the latter's champions. What is not acknowledged, however, is that this is the essence of liberalisation politics. Regardless of the rhetoric and possibly the intention of policy makers, questions of market opening are decided in a political tug-of-war between those wanting to protect their own turf and those wanting to invade it.

Market opening is not a unilateral process, pushed along by an abstract 'globalisation of financial markets'. It resembles trade politics and is the result of strategic interactions between negotiating parties. Milner (1988) found that firms' support for cross-border market liberalisation grows in line with the internationalisation of their own business. The same applies to financial markets (for the case of Germany, see Vitols 2003: 18).

In addition, as first steps towards cross-border openness eliminate domestic firms unable to withstand competition from abroad, domestic opposition to further opening erodes. Indeed, once domestic markets are dominated by foreign firms, the political rationale for protectionism disappears. In Europe, examples of such a dynamic include the telecoms and utilities industries. This is an example of a feedback loop between agents and (market-)structures that could be at the heart of politico-economic analyses of financial market change. Liberalisation may feed off itself because as firms adapt to transnational markets spaces, the constituency in favour of further market expansion grows.

Innovation and internationalization of financial market segments owe much to initiatives from financial services firms themselves and their attempts to exploit business opportunities. The emergence of the Eurodollar markets was condoned by UK authorities but driven by the business interests of firms active in UK markets (Burn 1999). Complex derivatives, discussed above, are another example (Partnoy 2002). As Berger et al find for international securities in general,

> the development of new financial products has primarily created markets for intermediaries rather than end users of these products. (Berger et al. 2000: 81f)

In other words, financial globalisation is primarily the domain of the firms at the heart of GFMs. It is no accident that the financial industry is the most fervent advocate of transnational market integration.

In their study of European bond markets, Casey and Lannoo find that financial firms are the primary issuers of international bonds, one of the most visible indicators of the internationalization of financial markets (Casey and Lannoo 2005: 13). In contrast to debt sold by financial institutions, corporate bonds—debt sold by non-financial corporations—only made up roughly ten per cent of total international bonds in the late 1990s (European Commission 2005: I-11). Rather than corporations' capital demands driving international markets, it has been sovereign debtors (i.e., governments) and financial firms themselves that have propelled these market forward.

Similar arguments can be made about investors in international capital markets. Who are the actors there? In equities, investment funds and pension funds have increased non-domestic holdings as a share of their assets, reaching over 50 per cent for both categories in 2000 (European Commission 2005: II-19). However, more than 50 per cent of the asset managers in continental Europe (weighted by assets) are owned by banks themselves and another 20 per cent by bancassurance conglomerates (European Commission 2005: II-16). Even in the UK, banks, insurance firms and conglomerates own almost 80 per cent of the asset managers. In some European countries, banks control almost 80 per cent of the fund management industry (Berger et al. 2000: 81f). The transnational market place created through financial liberalisation is not only promoted by financial firms—they are also the ones populating it.

Once firms' preferences are accounted for, the question remains how they manage to inject their preferences into public policy. When financial industries were nationally based, they had close ties with governments not least due to their quasi-official role in national economic policy (cf. Zysman 1983), and their preferential access to policy making became institutionalized (see e.g. Deeg 1999). That has been particularly true in coordinated market economies. In the US, traditional lobbying, hefty campaign contributions and a revolving door system between the SEC, the CFTC, the Treasury and Wall Street play all play an important role. In the UK, self-regulation has meant that firms were less dependent on the government to begin with.

With the globalization of the industry, some of these patterns have started to change. Firms effectively lobby international policy making institutions or promote transnational private regulation (Underhill 1995, Tsingou 2003). As financial markets continue to evolve, this question will deserve further attention. In any case, substituting empirical complexity for deductive conceptions about governments' motivations to change policy and stylized 'market mechanisms' generates a very different picture of how and why financial markets have been opened up in recent decades.

EU capital market integration

Recent EU capital market integration provides a telling example of double reflexivity at work.[2] Broadly, what capital market integration has been achieved is the outcome of a struggle over the degree and terms of cross-border market access in the European Union. More specifically, investment banks based in the City of London—many of them with US origins—have tried to facilitate access to clients in continental Europe. Dutch banks, having competitive business models and coming from a liberal environment, supported the project, as did the largest German banks, mainly owing to their size and international ambitions. At least throughout the 1990s, French banks, hitherto focused on their domestic market, spearheaded the opposition to what they considered excessive cross-border liberalisation. They were backed by many national industries in southern Europe—what became known as the Club Med (Story and Walter 1997, Underhill 1997).

[2] Much of the information for this section is based on more than 50 confidential interviews conducted in Brussels, Frankfurt, London, Paris and Berlin in 2005 and 2006.

The key to EU market integration lies in creating a regulatory framework that allows financial services firms to operate throughout Europe under a single regime. That can be achieved through pan-European rule harmonization or Europe-wide recognition of a firm's domestic regulatory and licensing regime. The first attempt to achieve integration culminated in the Investment Services Directive (ISD) in 1993. Because of protectionist impulses of domestic industries, particularly in the Club Med countries, market-opening was watered down to a degree that effectively made it a failure (Steil 1998). The Club Med countries had insisted on a 'concentration rule'. This rule could be used to force domestic and foreign investment banks to trade domestic securities on established domestic markets. French shares, for example, had to be traded to the Paris stock exchange. The ambition of investment banks to either trade these shares elsewhere or match orders from their clients in-house was defeated. So in the late 1990s, a second attempt was launched to create an integrated European markets—heavily supported by City-based investment banks. The episode that followed was a prime example of double reflexivity.

Historically, stock exchanges have been national share-trading cartels owned by members. As the top layer of these member firms—large banks and investment banks—internationalised their businesses throughout the 1990s, a growing number felt that their own international orientation fit less and less with the cartelistic exchange structures which obstructed innovation and investment in modern trading systems. The result was a wave of demutualization. Member firms privatized exchanges. They turned them into for-profit corporations that normally became listed on their own trading systems. Starting with smaller exchanges in Scandinavia and the Netherlands, this trend saw the creation of the Deutsche Börse AG, Euronext and a re-vamped London Stock Exchange towards the end of the 1990s. Because stock markets were booming, and share trading with them, the value of national exchanges—most of which still had national monopolies—had increased significantly. When the former members sold exchanges to the wider public by listing them, many pocketed substantial profits. But they had not foreseen that they had created new competitors that would do more to defeat their ambitions in remaking European capital markets than any other group of actors.

When the very first drafts of a revised Investment Services Directive circulated—then dubbed ISD II and acknowledged as the most important EU financial market directive of the last decade—it appeared to accommodate most of the top investment banks' wishes. It abolished the concentration rule and placed few limits on ‘systemic internalisation’: banks could match securities orders from clients in-house rather than being required to use exchanges. Effectively, investment banks could have acted as exchanges themselves. Where previously, firms from many continental European countries had opposed integration plans, progressing internationalisation of the sector had brought many of them on board. Industry associations such as the London Investment Banking Association, the International Securities Market Association and the European Banking Federation strongly supported the proposals and worked with the European Commission in developing them further.

The main opposition to these plans came from a group of actors that had not even existed a decade earlier—securities exchanges as independent for-profit corporations. Exchanges lobbied Brussels institutions—particularly the European Parliament—through the Federation of European Securities Exchanges and national governments individually. They managed to dilute original plans to a degree that investment banks had deemed unthinkable. Exchanges feared that banks’ internalising trading would rob them of their core source of revenue – trading fees. They managed to convince policy makers to introduce onerous requirements for banks performing systemic internalisation. Systemic internalisers, as they became known, have to ‘shop around’ on other trading venues for the best prices before they are allowed to match orders in-house. In addition, they have to feed trade data into centralised systems that monitor trading activity and establish market prices. The obligation for banks to record and store all phone calls with clients could only be averted at the last moment.

The changes in the eventual directive, no longer known as ISD II but as the Market in Financial Instruments Directive (MiFID), eroded the competitive edge over exchanges that investment banks had hoped for. Instead, the new requirements will force systemic internalisers to invest massively in new technology. Costs are expected to amount to billions of Euros. In addition, protracted negotiations spanning more than six years have generated a directive so complex that only the largest financial institutions will be able to take full advantage of its provisions. After initial enthusiasm, MiFID has become a source of great frustration for many investment banks.

Complaints about a regulatory overload—common in the industry—are more justified in this case than in many others, given the degree of detail in the legislation. MiFID and the changes it will trigger in European capital markets are not the result that any of the parties involved had hoped for. Ironically, from the perspective of investment banks, the frustration is due to a creation of their own – independent exchanges that emerged as their main competitors for trading services. City bankers privately admit that demutualization may not have been such an advantageous move. Indeed, the top seven investment banks in Europe—good for over 50 per cent of EU share trading—have announced in November 2006 that they will set up their own trading system. With such a step, the industry will have come full circle and revert to exchanges as members-only clubs. Only that now they are transnational in scope.

Agency as rule change and agency as business practice have come together in the remaking European capital markets. For core firms—both investment banks and exchanges—developing future business models and pushing for the 'right' regulatory conditions were two sides of the same coin. But both rule changes and business decisions turned out to have side effects that these actors had not foreseen. Understanding why European capital markets have turned out the way they have is impossible without acknowledging this double reflexivity in financial market transformation.

IMPLICATIONS FOR RESEARCH

What does an appreciation of structuration and double reflexivity add to our understanding of GFMs? First, it encourages researchers to look for agency to explain macro-changes, rather than seeking explanations in structural properties themselves (cf. Abell 2003). Competition in financial markets, to take one example, can be construed as a driving force behind change, but it tells us little about either the degree or the direction of change. Firms may co-exist peacefully for years in a competitive environment or fiercely contest each others market position. Competition leaves them a wide range of business strategies to address it, just as capital mobility leaves many responses to governments and market participants. Furthermore, how did competition arise? If competition is to have explanatory power it must have been absent before. At the same time, those actors likely to loose most from competition stand central in financial market policy communities. Rather than competition explaining wider change, the question is how competition arose in the first place. Similar arguments can be made for capital mobility: governments who allegedly adjust policies due to its pressures are themselves the originators of rule changes that has ushered capital mobility in. That makes 'capital mobility' weak as an explanation of wider financial market change. Analysts are right to ask how capital mobility ripples through financial markets. But that is different than attributing original explanatory power to it.

Second, it challenges researchers to understand how agents combine agency as rule change and agency as business practice when they try to achieve their goals. Not that both are always present simultaneously, but analytical frameworks should be open to the possibility. Certainly in the study of regulatory change in financial services, it is likely that both will play a role.

Third, it suggests more attention for the ways in which agency is itself triggered by structural developments. In a nutshell, this means understanding better the motivations of agents for choosing particular courses of action. Do governments care about voter support, ideology, technical problem-solving or their own market position as debtors or potential issuers of equity (in privatizations)? What motivates firms to embark on new business strategies (product innovation, or international or cross-sectoral expansion)? How do structural constraints influence their choice of strategy?

Finally, it cautions against understanding structural change as a linear processes. That is particularly true where change is explained with reference to other structural properties of global financial markets. Unintended consequences of agency should be the rule, not the exception. The balance between these and intended outcomes will vary from case to case, and researchers should explain this variation. Factors may be the number of actors involved, institutional complexity and stickiness, the diversity of actors' interests, the distribution of influence among them or the complexity of the issue involved. Still, a perspective that *assumes* that political or market outcomes are the intended results of agency runs the danger of misconstruing how these outcomes came about.

When researchers empirically map structuration dynamics they might proceed in a number of analytical steps derived from a general, simple model of financial market change (see *Fig. 2*). The concomitant questions listed below are consciously kept in general terms, yet they could most fruitfully be applied to concrete cases: market change in a specific sector, regulatory reforms, a firm's strategic reorientation, etc. Examples would be individual European Directives in the field, the rise of new classes of financial products (e.g. credit derivatives), the American Gramm-Leach-Bliley Act of 1999 that diluted financial market restrictions dating back to the 1930s, the decision not to regulate rating agencies in Europe or the current struggle around EU legislation in the field of clearing and settlement. For each question, potential answers are supplied in brackets. The order in which the steps are listed here does not imply a hierarchy. The sequence is cyclical, so the starting point is chosen for its convenience for the analyst, not ontological primacy.

[*Figure 2 about here (see annex)*]

1. Who are, in a given issue area in financial markets, the core agents?
    a. Who is active in the policy community? [*e.g. finance ministries, regulatory agencies, (investment) banks*]
    b. Who is active 'in the market' itself? [*e.g. public and private issuers, retail and institutional investors, (investment) banks, non-financial corporations*]
2. What are the stakes/objectives of these different agents in this domain (their 'identity')?
    a. What are their core stakes/objectives? [*e.g. generating profits for firms, increasing influence for regulatory agencies, generating political support and raising funds cheaply for governments*]
    b. What are the intermediary objectives derived from the core stakes/objectives? [*e.g. limiting competition, creating new products or gaining access to foreign markets for firms; supporting complex, oversight-intensive rules for regulatory agencies; closely consulting with the financial industry and accessing a wide investor base for governments*]
3. How does the contemporaneous financial market environment (the 'structure' agents confront) condition the various options agents have to achieve their core and intermediary objectives? [*e.g., which options do debtors have for funding and capital owners for investment, what competition do finanicial firms face and how much space is there for (new or existing) business strategies?*]
4. For 'agency through rule change':
    a. Which institutions (widely understood) condition the access of different agents to rule making? [*consultation procedures, resource intensity of providing input, informal networks, etc.*]
    b. How do different agents interact to bring about observable rule changes? [*the 'visible politics' of rule making*]
    c. How do these rule changes impinge on the activities of market participants? [*e.g. by allowing the introduction of new products, putting issuers of debt in competition with each other*]
5. For 'agency through business practice':

   a. Are there institutions that underpin the current market order (e.g. an oligopoly) and if yes, and how are they reproduced? [*e.g. rules that limit underwriting of government bonds to domestic firms, complicated recognition procedures for rating agencies or restrictive definitions of financial firms' permitted activities*]

6. How do the activities of market participants bring about change in overall market patterns?
7. How do changes in overall market patterns affect
   a. the range of core agents (cycle to question 1)? [*e.g. the rise of hedge funds*]
   b. the identity of core agents (cycle to question 2)? *[e.g. banks' focus on investment business]*
   c. the way in which agents can achieve their core and intermediary objectives (cycle to question 3)?

This model leaves from for different dynamics operating in the various steps of the sequence that are not reducible to one overall dynamic. Institutionalist, structuralist and agency-centric approaches do not compete with each other here. Instead, as Ikenberry put it using different labels,

> [t]he most useful analysis explores the interplay and historically contingent role of international-, societal-, and state-centred variables. In effect, we need a more encompassing set of reference points that provide guidance in selecting and incorporating the array of explanatory variables. (Ikenberry 1988: 222)

These reference points should arise from systematic comparison of different cases. In the first instance, the approach outlined above lends itself to historical research, focusing on diachronic comparisons and variation, for example in market rules [*the stipulated rise of private regulation*], political institutions [*the growth of international organisations in the field of financial regulation*] or market patterns [*the rise of credit derivatives and private equity transactions, the international success of American investment banks, changed patterns of government financial or capital flows, etc.*]. The two ensuing questions require empirical groundwork rather than lofty theorizing: in very practical terms, how have agents brought these changes about ? And second, how have prevailing conditions before the change motivated agents to initiate these changes? Once that process can be described, a wide variety of hypotheses can be tested. The broadest of them ask how the feedback loop as a whole can be characterised. If the assumption that financial market change is driven by commercial imperatives of firms is correct—at least in certain domains, for example high-value added products, one should observe a very different pattern than if it were driven by market efficiency or governments' attempts to secure access to cheap funding. Lower-level hypotheses could be added for smaller segments of the feedback-loop (the policy making institutions agents prefer in light of their own motivations, for example).

Diachronic comparisons can easily be complemented by synchronic ones. Different countries can be compared to establish which variation at which point in the feedback loop matters to let hitherto similar financial systems diverge. One could equally compare different market segments—banking and insurance, for example. Why has the one seen more transnationalization than the other? Such questions are already being asked today. But most answers given explain one set of structures with another set of structures (macro-macro explanations, cutting out the agency) or describe the politics behind change without ever coming full circle, showing how the politics bear the imprint of prevailing structures. That, however, would seem to be one of the core tasks of a politico-economic analysis of financial globalisation and its effects.

CONCLUSION

Agents in the global financial system affect their political and market environment in ways that are at odds with simplistic models of financial globalization. Hitherto, scholars have mostly dealt with this complexity in one of three ways: one cluster of scholarship has bracketed the 'unsystematic' part of transformation dynamics and solely focused on that part that lends itself to treatment according to 'rigorous', positivist standards often associated with American political science (cf. Cohen 2006). Strict methodological requirements have thus precluded asking wider questions about change in global finance. In addition, work in this vein faces the danger of reductionism and reification of those factors that are modeled as 'exogenous'. Phenomena like reflexivity, argued above to be an integral feature of financial market evolution, have little room here. A second strand of scholarship—(somewhat simplistically) identified by Cohen as 'British' IPE—has adopted a much more holistic approach. The evolution of global finance is considered part and parcel of the evolution of global capitalism as a whole. While the focus on the 'big picture' is laudable, work in this tradition often assumes an internal coherence of global capitalism that should be the object of critical investigation, not its starting point. Third, scholarship in a more historical tradition has often balanced an awareness of the bigger context of financial market development with the latter’s non-linearities. At the same time, it has rarely explicated the more general lessons that can be learnt from the case material it discusses.

Mindful of the importance of agency and reflexive feedback loops, this paper has presented a structurational model of financial market evolution. It has argued that the sequence of analytical steps suggested by it could help address some of the shortcomings of the different research traditions. ‘Theory-building’ in the traditional sense would focus on the different steps in this sequence through the use of the comparative method. At this point in particular, there is much room left for future research and hypothesis- and theory-building. This also means that complex phenomena like financial liberalization or market crises will rarely be explained by only one theory. Institutionalist dynamics would explain one bit, structuralist ones another and those focusing on personal perception and agency yet a third. These strands should complement each other rather than compete. Hopefully, such collaboration would generate research that has the argumentative rigor of positivist work, the eye for the big picture of the holistic approach and the consideration for details and contingencies of the historical one.

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ANNEX: FIGURES

Figure 1: Double reflexivity

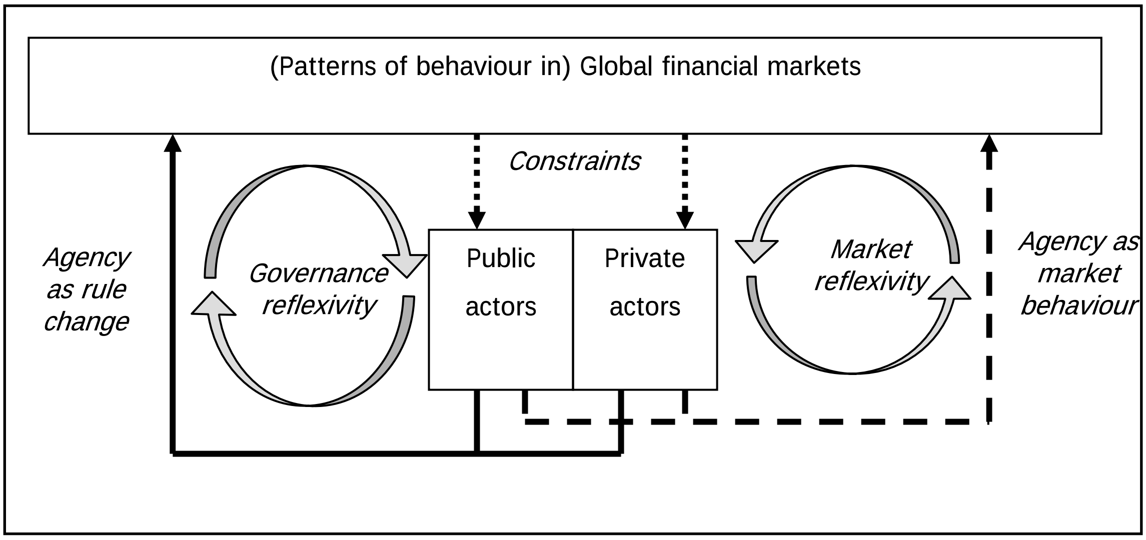

Figure 2: A structurational model