Room to Groove?
Standards of Civilization in the Development of International Financial Orders

Seabrooke, Leonard

International Center for Business and Politics

Working Paper No.13.

Copenhagen Business School
HANDELSHØJSKOLEN

International Center
For Business and Politics

Steen Blichers Vej 22
DK-2000 Frederiksberg
Tel. +45 3815 3585
Fax. +45 3815 3555
e-mail cbp@cbs.dk

Room to Groove?
Standards of Civilization in the Development of International Financial Orders

Leonard Seabrooke

Room to Groove? Standards of Civilization in the Development of International Financial Orders

Working paper no 13, 2005
Editor: Lars Bo Kaspersen

International Center for Business and Politics
Copenhagen Business School
Steen Blichers Vej 22
DK-2000 Frederiksberg
Phone: +45 3815 3583
E-mail: cbp@cbp.cbs
www.cbs.dk/cbp

ISBN 87-91690-13-7

Submitted to *Global Standards of Market Civilization*
Collection edited by Brett Bowden and Leonard Seabrooke
(Routledge/RIPE Series in Global Political Economy, 2006)

The use of a 'standard of civilization', a preferred form of socio-political organization, in global capital markets presents both constraints and opportunities for creditors and borrowers. When imposed, civilizing standards may change how a borrower would prefer to conduct their affairs. Creditors, after all, do not have the time and money to check every little detail and want clear performance benchmarks in economic life. At the same time, borrowers may present themselves as conforming to a civilizing standard to access capital and give themselves a greater capacity to conduct their own affairs. As long as they stay within the parameters of legitimate financial practice, the 'groove', creditors may well allow borrowers room for change in self-determined ways.

During the last two periods of intense financial globalization in the late-nineteenth/early-twentieth centuries and the late-twentieth/early twenty-first centuries, global standards of market civilization have firmly been in place. The character of these standards, however, has differed according to domestic political relations in the dominant financial powers of the day. Such relations, in turn, provided the context for investment from Western powers to 'emerging market economies' (EMEs), those states with a low or middle income economy and low investible market capitalization relative to gross domestic product (GDP) (Mosley 2003b: 103-4). This paper maps out the historical and conceptual terrain concerning civilizing ideas about the legitimacy of financial practices within global capital markets, and investigates the relations between Western 'civilizer's' and EMEs during the last two periods of financial globlalization.

The paper proceeds as follows: its first aim is to establish the historical context for the concept of civilization and its relationship to creditors and borrowers in both the public and private realms. Particularly relevant here is the importance of moral conduct in assessments of creditworthiness. The transition from community to individual assessments in creditworthiness over the last century, I argue, is analogous to the transition from assessments of clusters of like-states to independent sovereign states. The second task is to outline the domestic sources of civilizing ideas in the 'international rentier economy' of 1880 to 1915, particularly the importance of intense social connections for international investment that sustained an explicit standard of civilization. From there the third aim of the paper is to discuss the domestic sources of civilizing ideas in what I call the 'international creditor economy' of 1970 to 2005, emphasizing the importance of the financial 'disintermediation' to increase surveillance of sovereign states and the role of credit-rating agencies (CRAs). Finally, I reflect on the rationalization of legitimate financial practices in global capital markets and what agency EMEs have in conforming to the contemporary standard of market civilization.

CIVIZILING IDEAS IN CAPITAL MARKETS: AN HISTORICAL SKETCH

For a state, firm, township, or individual to access capital it must successfully signal to a creditor that repayment can be made without much of a fuss. Equally so, the creditor must be satisfied with how the borrower's ability to repay has been calculated according to the rationalization of finance practices of the day. There are strong incentives for the borrower to demonstrate that it has met standards of organization and self-control to pass this test. The borrower must represent itself as rational and predictable, for the opposite will only increase the creditor's concern about repayment and lead to a refusal of access to capital or the imposition of a premium on the price of a loan to compensate for the increased risk. Above all, the borrower must present itself as civil in the sense of being capable of self-control, in being recognized as a legitimate authority among peers, and through a demonstrated commitment to laws of sustained orderly conduct. In short, a borrower requires civilization to sustain capital inflows and avoid the incivility of default. This link between demonstrating a capacity for civilization and access to capital has always been the case and, for this reason, ideas of the state as civilizer of the market or the market as civilizer of the state are of interest to the historical development of global capital markets.

According to Max Weber, one defining aspect of the civilizations of Antiquity was the state's incapacity to convert hoards of precious metals into debt instruments to allow the flourishing of a capital market (Weber 1998: 45). Centralized monarchical systems in Antiquity preferred to tax their own populations rather than create credit from existing stores of value (precious metals, booty). They also placed caps on the capacity to make private profits to maintain an arms-length relationship with, and control over, private financiers. In contrast, Roman and Hellenic City states often taxed their domestic population to pay private financiers who effectively held them in debt bondage to extract higher profits (Weber 1998: 61-4, 211, 244).

In an attempt to tackle this problem, City states in the mediæval period, such as Genoa and Florence, obliged their propertied class to invest in interest free public debt. This did not, however, give states the upper hand. In the Genoese case power over taxing and governing the economy was ceded to creditors in the late fourteenth century upon default of repayment for funds lent for war-making. Creditors – in this case of the Bank of San Giorgio – were also able to use economic coercion to secure property rights more so than among political elites (Greif 2005: Ch. 8). Private credit relations engendered a civilizing process by mitigating conflict and providing more stable ground for the enforcement of contracts. Private markets, not the state, brought more civility to the growth of capital markets.

Prior to the building of legal and economic institutions that we identity as the modern state, most access to credit was city and township based and private authority over them was commonplace. Credit relations were typically held within what Avner Greif refers to as a ‘community responsibility system’, within which the incentive to default on a loan was low as the costs to creditworthiness of the community were high (Greif 2005: Ch. 10). In Western Europe default on a loan to a foreign creditor would commonly mean that the community was obliged to repay the creditor and then seek its own means of extracting the lost funds from the borrower. Private actors were in the driving seat in assessing the creditworthiness of borrowers according to their capacity to behave in a civilized manner.

Community rather than individual obligations in assessments of creditworthiness also extended to the creation of fairs for the exchange of debt instruments (mainy bills of exchange), such as the famous Champagne fairs of the thirteenth century. At such fairs communities rather than individuals would be represented, with the threat of default resulting in the potential for a community to be discredited, banned, or physically punished (Greif 2005: Ch. 10). In Continental Europe this led to an enforcement situation that we would associate today with the behavior of organized criminal gangs, with creditors hiring ‘hit men’ in the form of mercenary armies to enforce debt repayment from another community. Such criminal-type behavior provided the foundation for the modern state (Tilly 1992).

In the English case the state rather than private actors sought to provide the standard of civilized conduct within financial markets. The English state asserted itself during the late-thirteenth century by officially abolishing the capacity of debtors to extract rents from a community and encouraging the development of an individual-based contract system adjudicated by a central state administration. This change to a system we would identify as more modern, however, was hardly automatic and evolved over centuries. Moral conduct was still strongly associated with creditworthiness at a community level. Craig Muldrew's work (1998) demonstrates that within England between the sixteenth and eighteenth centuries there was intense pressure upon communities to conform to a standard of moral conduct. Such pressure led neighbors to pull each other into line for bad behavior, and to an explosion of literature on the moral decay associated with indebtedness, drunkenness, and other social sins, to curb impediments to creditworthiness.

Similar dynamics also occurred with foreign lending. Capital mobility within Europe increased greatly and the (now quarterly) international fairs provided means for creditors to not only settle bills of exchange but to gather information on borrowers. This increased market integration permitted long-term loans to be made according to international rather than local interest rates, which also opened up space for outrage at usury within capital markets (Goldthwaite 1998: 497-9). The rise of Antwerp as the premier financial center with deep and liquid secondary capital markets for public debt also increased the intensity and volume of trading and raised questions about creditworthiness assessments being made by close personal networks (such as the House of Fuggers) where usury was rationalized as legitimate financial practice and not morally unacceptable (Germain 1997: 36-9). As Amsterdam took over as the world's principal financial center in the seventeenth and eighteenth centuries, usury was seen as an unfair practice (similar dynamics were present in Islamic societies and their prohibition of usury as 'riba'). Financial relations should not be, according to this new rationalization, based on gambling but on moral and rational standards. As with the development of double-entry bookkeeping, which was held by Weber and others as a key to modern capitalism, one could find self-improvement through order and civility in finance (Carruthers and Espeland 1991: 41; Weber 1976: 76). Within capital markets the new mix of morality and rationalization could provide the foundations for a ‘universalisation and intensification of world credit practices’ (Langley 2002: 45). This new frame for legitimate financial practice grounded civility in the moral self.

Control over capital markets, but not a monopoly over civility, was still in private hands and distanced from the state. One group in particular who lived off their private investments in public debts, ‘rentiers’, had gained in economic and political prominence (Germain 1997: 42-3). This situation was prominent not only in Amsterdam but also in London and was important in preventing the extension of credit, and the deepening of capital markets, beyond personal, if internationalized, networks within the finance capitals. For credit to be extended a new set of legitimating financial practices was required and needed to be supported by the state.

As signaled above, in the English case the state was the market civilizer. The creation of the Bank of England (BoE) in the late-seventeenth century sought to ‘connect savers and the English Treasury’ and greatly expand the state’s capacity for war-making without falling captive to private financial interests (Quinn 1997: 411-13, 427). This followed the desire to develop a financial system that would make credit creation ‘less dependent on individual morality’ (Muldrew 1998: 329). Such freedom permitted the formation of a deeper capital base and allowed the City of London to become the world’s principal financial center. Other than providing a clearing house for bills of exchange (which also occurred in the European financial capitals like Amsterdam, Paris and, to a lesser extent, Berlin), London was unique in its capacity for borrowers to access capital for long-term private and government debt in EMEs (Germain 1997: 52). And with increased English political and economic prowess came a new need for a standard of civilization in global capital markets that reflected domestic political wrangling over ideas about both the meaning of civilization and how the English state should regulate financial relations at home and abroad.

CIVILIZING IDEAS IN THE INTERNATIONAL RENTIER ECONOMY

One significant source of England's international financial power was the growth of provincial joint-stock banks during the nineteenth century that drew deposits not only from the upper-classes but also the middle-classes (Seabrooke 2006: Ch. 3). The deepening of capital markets was also largely dependent on industry during this period. During the late-nineteenth century the Great Depression from 1873-96 sparked a significant change in the English financial system that was accompanied by a new government policy (by W.E. Gladstone) that sought to curb public expenditure and limit the power of rentiers who lived off government debt (Ingham 1984: 130, 234-5). Both factors led to a movement to concentrate capital in London by drawing it from provincial joint-stock banks. This trend increased during the 1880s and 1890s, leading to 'the breakdown of what had been for more than three decades, an efficient national market' and the establishment of an 'international rentier economy' (Davis and Gallman 2001: 890; Mann 1993: 292). This breakdown coincided with the development of intense personal networks among rentiers for creditworthiness assessment, the rise of imperialist 'finance capitalism', and an explicit standard of civilization concerning EMEs.

A key place to discuss what EMEs were creditworthy was Gentleman's Clubs, whose membership ballooned during the 1880s and 1890s, the same period when rentier-type foreign investments into

EMEs increased (Taddei 1999: 23). Consider, for example, the personal networks required for investment in the Argentine Canal Company, and the scandal that followed, that are detailed in Oscar Wilde's *An Ideal Husband*. While discussing personal creditworthiness related to the investment, Mrs. Cheveley comments to Sir Robert Chiltern: 'My dear Sir Robert, you are a man of the world, and you have your price, I suppose. Everybody has nowadays. The drawback is that most people are so dreadfully expensive' (Wilde 1993: 33). Georg Simmel also noticed this trend towards increasingly personal and gentleman-based networks of creditworthiness within England (Simmel 1978: 479).

Within such networks the key civilizing idea at play was one of development and modernization in EMEs through a paternalist/colonist arms-length rentier-type investment. At its extreme, the attitude here was that while 'savages' or barbarians knew the immediacy of their economic desperation more than any 'civilized' person, they trapped themselves in their magics and irrationalities and were unable to embrace capitalism and its 'rational orders' (Weber 1988: 449-50). The maintenance of an idea about who conformed to a standard of civilization and who did not – through a ranking of peoples and their capacity for socio-political self-organization – could therefore be justified. The same applied for colonialism, whose 'watchword', as Norbert Elias famously commented, was 'civilization' (Elias 2000: 431).

The idea of an explicit standard of civilization provided a clear distinction on who qualified for protection under international law among a circle of civilized states, and who could be coerced, as seen in the proliferation of unequal treaties. Moreover, the notion that arms-length investment was part of a 'civilizing mission' provided a moral justification for the use of coercion backed by public authorities should default occur. According to this logic, default provided a key indicator of a failing to provide socio-political self-organization, a failure to meet a standard of civilization that invited further intervention from European states on a moral quest to civilize.

While rentiers and others who frequented Gentleman's Clubs preferred arms-length investments, they were certainly busy making deals. London-based investment ballooned during the period between 1890 and 1913 and by the eve of World War One, 44 per cent of global investment was made through the City of London (Fishlow 1985: 394), and one-third of British wealth was now being invested abroad (compared to 17 per cent in 1870, see O'Rourke and Williamson 1999: 208). Of this, the lion's share went to EMEs which, for the period, included states like Argentina, Australia, Denmark, Italy, Japan, Spain and the United States (see Bordo, Eichengreen and Irwin 1999: 51, n. 57). In fact during this period EMEs were receiving 63 per cent of global foreign direct investment, while in the last quarter of the twentieth century they received only 28 per cent (Baldwin and Martin 1999: 20). English portfolio investment went overwhelmingly into moderate-to-high risk debt securities within EMEs and was heavily concentrated in government debt and heavy industries such as railways, mining and metallurgy (Bordo, Eichengreen and Kim 1998: 17). In addition to investment in colonial territories and the US, which accounted for 44.8 per cent of investment in 1913-14, Asia and Africa received 25.9 per cent of investment and Latin America 20.1 per cent (Mosley 2003b: 255). A most popular and profitable investment – as Mr. Wilde suggested – was in financing infrastructure projects in Argentina.

During this period of financial globalization, financial crises were infrequent but severe. Crises in Argentina in 1890 and the US in 1893 were worse than EMEs hit by the Asian financial crisis of the late-1990s (discussed below), with negative growth rates compared to the pre-crisis year of, respectively, 14 per cent and 24 per cent (Bordo, Eichengreen, and Irwin 1999: 53-4). Given that the stakes were high, rentiers and institutions in the City of London sought to protect their investment by two mechanisms increasing their power of surveillance over existing and potential borrowers. The first mechanism was through the formation of the Corporation for Foreign Bondholders (CFB) which was initially founded in 1868 but which received a big push from the English government when foreign investment boomed. From the 1870s, this creditor association negotiated with EME governments, such as Turkey, Peru, Mexico and Argentina, with positive results in, according to the CFB's own reports, 'enlightened countries' (Mauro and Yafeh 2003: 9). Much of this success was from a growing surveillance capacity, whereby officers in borrowing countries would send back financial and political data to London to inform investors of the political and economic situation. Such surveillance gave EMEs strong encouragement to demonstrate their capacity for self-organization, particularly as recalcitrant borrowing states could be 'blacklisted' by the CFB from international borrowing (Kelly 1998: 31-6, 42). Clearly the CFB strategy had an effect. For example, Venezuela who had threatened default in 1902 was praised in 1908 as a model to their Latin American neighbors (Mauro and Yafeh 2003: 9, 12-13).

In cases of default with no capacity for immediate payment the CFB would arrange debt for equity swaps, acquire tax revenues, or seize physical assets for sale (note that the predominant forms of investment were in capital intensive products). But how could a private association of creditors punish a government that failed to meet a standard of civilization by defaulting? The second mechanism used by rentiers and financial institutions to impose a civilizing standard was much more direct and involved their political links with the English state. The CFB had close ties to H.M.'s Treasury and Foreign Office, as did rentiers. For example when the Venezuelan government proposed default to its creditors in 1902, the reaction from England, Germany and Italy was to send naval forces. Venezuela paid up what was owing to these creditors within four years. Similarly, the US invaded the Dominican Republic in 1905 and seized customs revenue, and England threatened Peru in 1907 (Mosley 2003b: 270). This practice was not uncommon, nor was it particularly frowned upon. For example, the Hague Convention of 1906 accepted the use of force to guarantee investment in extreme cases where defaulters refused international arbitration (Mauro and Yafeh 2003: 23).

But like the change in ideas about usury a couple of centuries earlier, the imposition of military pressure within global capital markets became viewed as morally inappropriate and incongruous with the idea of civilization. In the early 1900s the Argentinean jurist and foreign minister, Luis Drago, argued at international conferences that 'Britain's normal, if not absolutely invariable practice has been to take coercive military or naval measures, or to threaten them, in defence of her citizens, only when these were wronged by the seizure of their property or by personal injuries' (Lipson 1985: 54). The purpose of such a bold statement was to sway global public opinion against the use of the threat of force to secure repayment. At the 1906 Hague Conference, England dismissed such calls as piffle. England, so went the argument, had a right to intervene in 'countries of doubtful honour' (read: uncivilized) to protect the property of English citizens (Kelly 1998: 43). However, at the Hague Conference of 1907, in the same year Peru was threatened, England signed the 'Drago Doctrine' (named after the Argentine jurist) that publicly recognized that the use of physical coercion was neither morally appropriate nor a legitimate financial practice. So, why the sudden change of heart? In short, the use of publicly provided dreadnoughts for private profit had become politically unacceptable within the English polity. By 1906 the Liberal Party was in government and was pursuing an agenda that picked up on public sentiment against rentiers and their dependence on profits from international portfolio investment. The Chancellor of the

Exchequer and future Prime Minister, David Lloyd George, publicly argued that rentier were unwilling to pay fair taxation for the warships, that protected their private interests. Lloyd George drew upon incidences such as those in Venezuela and Peru to put forward this case for increased taxation upon rentiers and the rich in the infamous ‘People’s Budget’ of 1909-10 (Seabrooke 2006: Ch. 3).

During the period a range of political activists and scholars pursued a ‘social liberal’ agenda that saw the state as the ideal civilizer in capitalist market relationships, at home and abroad, and an idea of civilization as human betterment rather than material preponderance. John A. Hobson, for example, argued that imperialism was a ‘mission of civilization’ underpinned by a problem of economic underconsumption created by rentiers (Hobson 1902; Seabrooke 2004). As opposed to CFB’s use of state-coercion to created ‘enlightened countries’ receptive to capital investment, Hobson argued that a true meaning of civilization would compel the state to intervene into the domestic economy and redistribute wealth to create an ‘enlightened community’ by boosting the general standard of living and permitting more time for education and moral self-reflection (Hobson 1901: 254). The personal credit networks described above were deemed to be against the broader social interest. As ‘credit is an essential element to liberty’ it was the responsibility of the state, not personal networks, to assist the broader population in using credit to better their standard of living (Hobson 1909: 105-6). This domestic attitude should also apply internationally and rather than imperialist financial practices that corroded ‘the meaning of civilization’, international institutions should be created to embody an idea of civilization as human betterment (Hobson 1936: 211). Within England, social reform movements called for the state to civilize finance for the betterment of all, while rentiers and the City of London clung to a conception of a standard of civilization that permitted imperialist finance capitalism. The result of such tensions could be seen in the English middle-classes on the eve of the war, which Michael Mann refers to as 'superloyal schizoids'; at once tied to the idea of social progress and imperialism (Mann 1993: 292, 583).

Ultimately the imperialist investments collapsed under the weight of World War One and reflected their shaky domestic foundations. Capital flows to EMEs dried up in the 1920s to 1930s and during the 1950s-1960s more than half of all capital going to EMEs was politically-driven foreign aid rather than investment (Armijo 1999: 17). As we will see below, investment from Western powers into EMEs only picked up again in the 1970s and 1980s. Financial practices transformed to become less dependent on the kinds of personal credit networks described by Wilde and others, and more institutionalized and impersonal. The opportunity offered here was that the state could act domestically as guarantor to legitimate credit access for those previously banned, and that in global capital markets EMEs could present themselves as sovereign states who asserted their creditworthiness without fear of physical coercion. Akin to the transition from community to individual creditworthiness assessments described above, the new system offered greater *potential* for states to put themselves forward as single units rather than clustered together as barbarians under a civilizing mission. In this new 'international creditor economy' the idea of civilization would become intimately tied to institutional surveillance and less personalized markets. But the emphasis on EMEs demonstrating a capacity for socio-political self-government remained.

CIVILIZING IDEAS IN THE INTERNATIONAL CREDITOR ECONOMY

For EMEs the modern story begins in the 1970s, following the collapse of the Bretton Woods system due to the US's incapacity to readjust the value of the dollar to gold within the fixed exchange rate system and its support for credit creation through private US financial institutions operating in the Euromarkets (Seabrooke 2001: 61-6). During discussions concerned with how to put the world financial and monetary system back on track, the oil crisis of 1973, where oil prices quadrupled, led enormous amounts of capital to flow from Western powers to the Organization of the Petroleum Exporting Countries (OPEC). Most of this capital, some $30 billion in 1974 alone, was 'recycled' through the Euromarkets then lent out to states whose balance of payments had been thrown into disarray (Frieden 1987: 88, 130). The oil crisis and the move to floating exchanges permitted a massive expansion in private capital through credit creation. While the amount of long-term private capital exports in global markets was 1:1 with public long-term capital exports from 1955-1971, between 1972-76 the ratio changed to 2:1 (Germain 1997: 119).

As a consequence of the above changes a two-tier system of creditworthiness within global capital markets quickly developed. Western powers could borrow directly from global capital markets, particularly the Euromarkets, while EMEs relied on international bank loans (Cohen 1981: 50). Such lending was particularly attractive to Western states because domestic 'stagflation' was impeding their profits. The syndicated bank lending game, by contrast, was simple: a bank would go in with others to provide a loan to an EME, with the logic that being responsible for only one-tenth of a loan was sensible risk management. The lending of 'jumbo' loans of $500 million and 'mammoth' loans of $1 billion became commonplace and, interestingly, 80 per cent of the borrowers were governments in EMEs. The International Monetary Fund (IMF) and the Bank for International Settlements (BIS) became increasingly concerned about this activity, since it was not clear whether the banking syndicates were sufficiently scrutinizing the borrower's capacity for socio-political self-organization; nor were they watching what other syndicates were doing. Furthermore, Western banks were halving the amount of capital they put aside in case of crisis in comparison to their assets (their 'capital adequacy ratio') (Seabrooke 2001: 95-8). They also assumed that international institutions would not permit a sovereign state to go bankrupt, increasing their 'moral hazard' and incentive to lend more to EMEs.

The banks engaged in syndicated bank lending to EMEs assumed that the borrowing government could sufficiently trade in international markets to gain the necessary export earnings to make repayments and avoid default. However, problems of 'surplus capacity' (a glut in trade) and an increase in US interest rates (most loans to EMEs were denominated in dollars) made this impossible. EMEs in Latin America soon began to default on their loans and a private creditor association, the London Club, and a public creditor association, the Paris Club, went into negotiations with the EMEs. As in the earlier period of financial globalization, default was interpreted as a failure in self-organization. However, unlike the CFB, these clubs' purpose was negotiation and not surveillance. The job of restructuring EMEs to meet a modern standard of market civilization fell upon international institutions.

Following the debt crisis, private lending to EMEs plummeted and foreign aid rather than investment was once again EME's largest source of capital (Armijo 1999: 17). During this low-point a new two-tier system emerged in global capital markets during the 1980s and 1990s. Western powers became more enmeshed with global capital markets as they initiated a process, especially in the US, of financial 'disintermediation'. This process led to the replacement of traditional forms of lending from financial institutions, like bank loans, to the increased use of debt securities such as bonds and notes, as well as investment in stocks (Seabrooke 2005b). Surveillance of creditworthiness here was overwhelmingly conducted by private actors. EMEs increasingly engaged in this process but were now dependent on funds from international institutions and private bank lending when it was available. This was especially the case with EMEs who were financially insolvent rather than just strapped of cash. To make EMEs more creditworthy, international institutions promoted a rolling back of the state from economic management and encouraged a state's self-organization through 'neoliberal' market mechanisms. The key policy changes included strict limits on government expenditure, the privatization of public assets and services, the introduction of a broad-based taxation system (such as Value Added Tax), a low debt burden relative to GDP, and an independent central bank that could keep inflation low. Clearly international institutions saw the market, rather than the state, as the chief civilizer. Furthermore, this new standard saw the 'neoliberal' global market as the best means to bring democratization to EMEs and, in doing so, prevent political instability. While the previous period of financial globalization saw the use of an external military presence to civilize, the contemporary period saw the use of neoliberal markets as a way of preventing internal military coups (Armijo 1999: 35; Haley 2001: 64-5). Through market discipline and democratization, so the logic went, an EME could become civilized.

The creation of this new two-tier system and the ideas that drove it reflected domestic politics within the principal financial power of the time, the US. When the debt crisis hit, the top nine US banks had lent 140 per cent of their capital to governments in Latin America (Reinicke 1995: 142). Such banks cried foul, arguing that the US and other Western governments had encouraged them to lend to EMEs 'as a matter of public interest', and that they should be bailed out by the US taxpayer (Cohen 1986: 40). A range of community groups, activists, and politicians contested the legitimacy of this claim and argued that rather than a bail-out, any US banks with bad debts to EME governments should have a premium placed on their borrowings within the US domestic financial system. Such a severe reaction was soon legislated through the International Lending Supervisory Act of 1983 and sounded the death knell to international syndicated bank lending. This domestic political reaction was also timed during a ‘rentier shift’ in which excessive entrepreneurship and permissive regulation fostered domestic bank and thrift crises, furthering domestic concern about creditworthiness assessment. The subsequent reforms to the US financial system in the late-1980s and early-1990s reflected the need to tighten creditworthiness criteria and encouraged the rationalization of its assessment through ‘objective’ financial and social data. Within the US, activists and community groups campaigned for minority groups to have increased access to personal credit, particularly for housing. As a consequence of political wrangling, legislation was passed, such as the 1989 bolstering of the Home Mortgage Disclosure Act of 1975, that required financial institutions to take data from all potential clients about their gender, ethnicity, and age to prevent banks from ‘redlining’ communities they considered as not able to manage their own affairs, those not considered fully civilized. In addition, the new financial practice of securitization – where the flow of capital from a dependable asset, such as a home mortgage, was ‘pooled’ with others and then sold as new debt to a third party – was also becoming prominent and of great personal benefit to ‘ordinary Joes’ (Seabrooke 2006: Ch. 5). The domestic encouragement of disintermediation and securitization led to deeper domestic capital markets and furthered use of debt securities in global capital markets. It also gave rise to the explosive growth of institutional portfolio investment that followed the rationalization of creditworthiness through objective financial data.

The growth of institutional portfolio investment and the mechanisms through which it sought to assess the creditworthiness of EMEs provided a new standard of civilization in global capital markets. In contrast to the intense personal networks within Gentleman’s Clubs and the City of London more generally, institutional investors relied, primarily, on depersonalized information from international public and private institutions. Rather than an explicit discourse about how global capital markets could provide the uncivilized with civilization (as long as there was a dreadnought in their harbor to remind them to pay their dues), the modern standard of civilization relies on impersonal market signaling. As portfolio investment in types of debt securities like bonds (basically 'IOUs' with interest) and equities (shares in an enterprise) are the responsibility of the recipient government or private enterprise, EMEs were actively required to demonstrate to market actors that they have the capacity for economic and socio-political self-organization.

EMEs in the contemporary period include most states in Latin America, East and Central Europe, and East and Southeast Asia (poorer states in Africa, Eastern Europe, the Caribbean, and South Asia are now referred to as 'Frontier Economies'; for a list see Mosley 2003b: 104). During the 1980s many EMEs embroiled in the debt crisis were encouraged to convert non-performing syndicated bank loans into bonds, such as the Brady Plan's creation of 'Brady Bonds' from 1989 onwards (more than half of all EME government debt bonds were of this type in the mid-1990s). While for much of the 1990s Eastern European and Southeast Asian EMEs relied on international bank loans (from European and Japanese banks, *not* US banks), EMEs issuing of bonds grew considerably in the late-1990s, from $13.9 billion in total in 1991 to $127.9 billion in 1997 (Mosley 2003b: 108). Indeed, by the early twenty-first century, EMEs were using the issue of debt securities as their key means of financing. Between 2000 and 2004, EMEs issued an average of $92.5 billion in bonds and $28.2 billion in equities per year. The lion's share of new debt issued (including loans) was by Asian EMEs with $83.5 billion and Latin American EMEs with $50.6 billion (IMF 2005: 11). For EMEs this market could provide greater flexibility and potentially more investment, while the creditors and portfolio investors had a relatively easy means of pulling out one's capital in times of trouble.

The key concern for investors in EMEs is the capacity to repay and, when there is a perceived lack of financial information to assess creditworthiness, who governs the state (Mosley 2003b: 124-7). The financial crises of the 1990s would confirm this view. For example, between 1990 and 1993, one-fifth of all net capital inflows to EMEs went to Mexico, and particularly US private investment into government debt securities denominated in US dollars called *tesobonos* (Strange 1998: 96-7). An increase in US interest rates led to speculation on the Mexican government's capacity to pay on all outstanding *tesobonos*, which then fuelled fear and capital flight, leaving Mexico with $55 billion in outstanding debts. Mexico then went cap in hand to the IMF, who were unable to lend the sufficient funds alone due to a US veto (the US owns the largest share of the vote – 17.4 per cent – on all 'special decisions' within the IMF that require 85 per cent of members to be in favor). Similarly the Asian financial crisis of 1997-98 was worsened by unrealistic expectations about the value of international investments in real estate and stock markets that could not be sufficiently verified to calm investors' nerves (Seabrooke 2001: 165-7, 180-7). Again the IMF was embroiled in a struggle with the US in trying to lend; a struggle that is fundamentally steeped in US domestic politics, particularly the view among the US public that under no circumstances should US taxpayer monies be used for bail-outs from financial crises (Broz 2005).

Perhaps as a consequence of being short on funds, the IMF has redefined its purpose from providing funds for balance of payments problems to, instead, making surveillance of economies the 'very core of the institution' (Pauly 1997: 41), and presenting itself as a 'technocratic shepherd of the wayward [with a]… "neo-civilizing mission"'' (Hall 2003: 95). As a consequence, EMEs who borrow from the IMF have increasingly learnt to 'talk the talk' in adopting the 'civilized' institutional structures without actually changing political and economic practices on the ground; a scenario that has led the IMF to talk increasingly about its frustrations with the lack of 'political will' and reform program 'ownership' within borrowing states (Seabrooke 2005a). It is also in this context that the IMF has called for EMEs to increase their reportage of their observance of standards and codes to demonstrate their 'transparency' to unmask barriers to 'political will'.

One lesser known but vitally important actor that operates a standard of civilization in contemporary global capital markets are CRAs who seek to provide 'developed country "government-at-a-distance" over developing countries' (Sinclair 2005: 147). CRAs such as Moody's and Standard & Poor's (S&P) rate the creditworthiness of EMEs for both sovereign and corporate debt securities according to set objective criteria (overwhelmingly financial data) that further the rationalization of financial practices within global capital markets and follow a neoliberal view of the market as civilizer. Their power is considerable. For example, during the Asian financial crisis CRAs quickly and severely downgraded Thai government and corporate debt, creating fear among investors that other EMEs in the region were likely to have repayment problems, which then furthered financial contagion. Such behavior is complicated by the fact that CRAs have a track record of only downgrading EMEs' debt securities once the crisis has begun, prior to which they were enthusiastic supporters of more investment and lending into EMEs (Rojas-Suarez 2001: 6). In addition, there is evidence to suggest that CRAs retain cultural and societal preferences, a ranking of peoples to put it crudely, within global capital markets. Asian EMEs for example, are thought to be favored over Latin American EMEs as more reliable (Sinclair 2005: 137).

In considering CRAs, however, we should note that rationalization of financial practices provides both constraints and opportunities for EMEs. For starters, there is significant path dependence in CRA ratings (from 'AAA' or 'Aaa' for best quality through to 'C' or 'D' for lowest grade). Layna

Mosley found that 97 per cent of states rated with an S&P ‘AAA’ receive the same rating the following year, with such continuity only diminishing to 75 per cent for states rated as ‘B’ (2003b: 141). Such path dependence suggests that CRAs are not looking as closely as market actors would hope. Also, research suggests that in the most recent financial crises, such as in Asia in 1998, Russia in 1998, Turkey in 2000-01, Argentina in 2001, and Brazil in 1998-99 and 2002, EMEs were able to lessen the negative impact of CRAs by signaling financial data, such as consumer price index information, directly to institutional investors (Andritzky et al. 2005: 15-16). EMEs have actively engaged CRAs. During the 1990s there was a sevenfold increase in the number of EMEs who wanted their debt securities rated by CRAs (IMF 1999: 202).

As Timothy J. Sinclair’s work establishes, CRAs propagate an ‘“operating system,” or mental schemata’ for how EMEs should self-organize their economy and, implicitly, their polity based on a neoliberal model that favors the US (Sinclair 2005: 177). These civilizing ideas are powerful and provide a framework for action, but they also open up potential space for EMEs to have agency. For example, there are good grounds for thinking that CRAs, and financial market traders in general, are not watching every movement within EMEs. Javier Santiso’s (1999, 2003) extensive interviews with market participants in emerging markets trading demonstrates that the rationalization of financial practices within contemporary global capital markets is increasingly self-referential and based on a short-term trading memory. He found that a debt securities’ turnover timing (90 days, yearly, five years) is the only time of assessment for most traders, leading to trading based on key indicators according to global standards of the day and with little memory of what has occurred in the past. As one of Santiso’s interviewees stated, ‘The market is a giant autism’ (Santiso 1999: 318). Similarly, Ezra W. Zuckerman’s research (1999; 2004) on stock market activity within the US finds that as long as actors provide market signals that conform to expected standards and perceptions of legitimate financial practice, the market will not scrutinize them intensely as outliers.

While it is indubitable that the predominating structures within global capital markets are stacked against EMEs, the contemporary system places the emphasis on EMEs signaling their creditworthiness to the market rather than being lumped under an explicit civilizing mission. And while this may be no less invasive to EMEs than the previous period of financial globalization, EMEs arguably have greater agency to attract investment without the use of force and with the capacity to signal information to market actors in their hands. The same, however, cannot be said for the 'Frontier' economies, most of which are African, that are heavily dependent on international institutions like the IMF and the World Bank. These Frontier economies must follow the IMF and World Bank's standard of civilization, through the Highly Indebted Poor Countries (HIPC) and Poverty Reduction and Growth Facility (PRGF) initiatives, to effectively demonstrate their creditworthiness prior to having access to, or interest from, global capital markets.

CONCLUSION

This paper has traced the development of civilizing ideas and financial practices between the state and the market, and between Western powers and EMEs, in global capital markets. We have seen a shift between the idea of the state as the civilizer of markets and the counter notion that the market should civilize. One vitally important process to understand in the creation of standards of civilization in global capital markets is the process of rationalization of legitimate financial practices. As discussed above, morality is intimately tied to assessments of civility and creditworthiness. In the mediæval period we noted that the creation of 'rational' and orderly financial practices was tied to the moral self, and that this micro-level behavior was then translated into macro-level changes with the rejection of usury as morally repugnant. Morality and civilization are, however, ambiguous bedfellows. In the international rentier economy, a moralizing discourse about the West's civilizing mission permitted investment in EMEs based on a notion of civilizational superiority that should be backed by military force.

The contemporary standard of civilization in global capital markets has eschewed explicit moral language and concentrates instead on 'objective' financial data assessed by institutions (MacKenzie 2003). As the rationalization of financial practices is not natural but constructed by the ideas of actors engaged in capital markets, it can be contested. Indeed, moral pressure placed upon EMEs by institutions can also run both ways. For example, to garner international legitimacy, since 1999 the creators of contemporary global standard of market have sought input from EMEs (mainly through the Group of Twenty (G20)) in discussing the 'Global Financial Architecture' and financial stability (Germain 2001: 422).

The rationalization of civilized standards in contemporary global capital markets provides clear incentive for EMEs to conform to standards if they wish to attract investors. This is particularly the case as institutional investors make up 90 per cent of their investment (Haley 2001: 33-42), and the top 20 EMEs – assessed by capital inflows – attract 83 per cent of all investment to EMEs (the top five in 1997 were China, Brazil, Argentina, South Korea, and Mexico, see Mosley 2003b: 107). One may therefore expect a great deal of 'institutional isomorphism' among EMEs who wish to signal to actors in financial markets that they are a safe but lucrative bet (DiMaggio and Powell 1983), and many political economy scholars have noted the extent of policy diffusion and convergence in how EMEs govern their economies (Simmons and Elkins 2004; Chwieroth 2005).

EMEs, however, do not simply adopt ‘policy diffusion’ or international norms on financial practices lock, stock, and barrel. Rather, propagated ideas and principles go through a process of bricolage where local content is added to make changes more domestically acceptable (Campbell 2004: 65). We should not automatically assume that conformity with neoliberal institutions places EMEs on path dependent development from which they have no capacity to deviate (Crouch and Farrell 2004).

Contemporary global capital markets are rationalized around the gathering and analysis of financial data to the extent that as long as borrowers demonstrate their conformity with civilized institutions and legitimate financial practices they may have ‘wiggle room’. This is not to dismiss the great structural constraints that private financial actors and international institutions place upon EMEs to impose a standard of civilization to produce a certain type of socio-political self-organization. Many will agree, myself included, that a standard of civilization should not be imposed where it is not wanted. At the same time, we should not discount the fact that with sovereign protection and the responsibility for market signaling in their court, EMEs’ access to global capital markets provides a hitherto unavailable capacity for a states’ self-flourishing with policies it can inform and shape to accord with social norms and domestic political institutions (Guillén 2001; Brooks 2005). Surely this is superior to having a foreign warship in the harbor or, worse still, being ignored. In conclusion, and to take a twist on Mosley’s (2000) view of developed states having ‘room to move’ in global capital markets, as long as EMEs can ‘talk the talk’ to signal that they are operating within the parameters of civilized standards and legitimate financial practice, they very well may have more ‘room to groove’.

References

Andritzky, J.R., G.J. Bannister and N.T. Tamirisa (2005) 'The Impact of Macroeconomic Announcements on Emerging Market Bonds', IMF Working Paper WP/05/83, Washington, DC: International Monetary Fund.

Rojas-Suarez, L. (2001) 'Can International Capital Standards Strengthen Banks in Emerging Markets?', Institute for International Economics Working Paper 01-10, Washington D.C.

Armijo, L.E. (1999) 'Mixed Blessing: Foreign Capital Flows and Democracy in Emerging Markets', in L.E. Armijo (ed.) *Financial Globalization and Democracy in Emerging Markets,* Basingstoke: Macmillan, 17-50.

Armijo, L.E. (2001) 'The Political Geography of World Financial Reform: Who Wants What and Why?', *Global Governance* 7: 379-96.

Armijo, L.E. (ed.) (2002) *Debating the Global Financial Architecture,* Albany: SUNY Press.

Carruthers, B.G. and W.N. Espeland (1991) 'Accounting for Rationality: Double-Entry Bookkeeping and the Rhetoric of Economic Rationality', *American Journal of Sociology* 97: 31-69.

Blyth, M. (2002) *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century,* Cambridge: Cambridge University Press.

Bordo, M. D. and A.J. Schwartz (1994) 'The Specie Standard as a Contingent Rule: Some Evidence for Core and Peripheral Countries, 1880-1990', NBER Working Paper No. 4860, Cambridge, Mass: National Bureau of Economic Research.

Bordo, M.D., B. Eichengreen and D.A. Irwin (1999) 'Is Globalization Today Really Different than Globalization a Hundred Years Ago?', NBER Working Paper No. 7195, Cambridge, Mass: National Bureau of Economic Research.

Campbell, J.L. (2004) *Institutional Change and Globalization*. Princeton: Princeton University Press.

Chwieroth, J.M. (2005) 'Bringing States Back In (Again): U.S. Power and the Diffusion of Capital Account Liberalization to Emerging Markets', unpublished manuscript, London School of Economics, September.

Crouch, C. and H. Farrell (2004) 'Breaking the Path of Institutional Development? Alternatives to the New Determinism' *Rationality and Society* 16: 5-43

Cohen, B.J. (1981) *Banks and the Balance of Payments: Private Lending in the International Adjustment Process,* in collaboration with Fabio Basagni, London: Croom Helm.

Kelly, T. (1998) 'Ability and Willingness to Pay in the Age of Pax Britannica, 1890-1914', *Explorations in Economic History* 35: 31-58.

Cohen, B.J. (1986) *In Whose Interest? International Banking and American Foreign Policy*, New Haven: Yale University Press.

Davis, L.E. and R.E. Gallman (2001) *Evolving Financial Markets and International Capital Flows: Britain, the Americas, and Australia, 1865-1914,* Cambridge: Cambridge University Press.

Dimaggio, P.J. and W.W. Powell (1983) 'The Iron Cage Revisited: Institutional Isomorphism and Collective Rationality in Organizational Fields', *American Sociological Review* 48: 147-160.

Eichengreen, B. and M.D. Bordo, (2002) 'Crises Now and Then: What Lessons From the Last Era of Financial Globalization?', NBER Working Paper No. 8716, Cambridge, Mass: National Bureau of Economic Research

Elias, N. (2000) *The Civilizing Process*, Oxford: Blackwell.

Frieden, J.A. (1987) *Banking on the World: The Politics of American International Finance*, New York: Harper & Row Publishers.

Germain, R.D. (1997) *The International Organization of Credit*, Cambridge: Cambridge University Press.

Goldthwaite, R.A. (1998) 'Banking in Florence at the End of the Sixteenth Century', *Journal of European Economic History* 27: 471-536.

Gould, E.R. (2003) 'Money Talks: Supplementary Financiers and International Monetary Fund Conditionality', *International Organization* 57: 551-586.

Greif, A. (2005) *Institutions: Theory and History,* Cambridge: Cambridge University Press.

Reinicke, W.H. (1995), *Banking, Politics and Global Finance: American Commercial Banks and Regulatory Change, 1980-1990,* Aldershot: Edward Elgar.

Helleiner, E. (1994) *States and the Reemergence of Global Finance*, Ithaca: Cornell University Press.

Hobson, J.A. (1901) *The Social Problem*, London: James Nisbet.

Haley, M.A. (2001) *Freedom and Finance: Democratization and Institutional Investors,* Basingstoke: Palgrave.

Independent Evaluation Office (2003a) *Fiscal Adjustment in IMF-Supported Programs,* Washington: IMF.

Independent Evaluation Office (2003b) *The IMF and Recent Capital Account Crises*, Washington: IMF.

International Monetary Fund (1999) International Capital Markets: Developments, Prospects, and Key Policy Issues, Washington, DC: IMF.

International Monetary Fund (2005) 'Financial Market Update – June 2005', International Capital Markets Department, Global Markets Analysis Division, Washington, DC: IMF.

Langley, P. (2002) *World Financial Orders*, London: Routledge.

Leaver, R. and L. Seabrooke (2000) 'Can the IMF be Reformed?' in W. Bello, N. Bullard and K. Malhortra (eds.) *Global Finance*, London: Zed Press, 96-113.

MacKenzie, D. (2003) 'An Equation and its Worlds: *Bricolage*, Exemplars, Disunity and Performativity in Financial Economics', *Social Studies of Science* 33: 831-68.

States, 1760-1914, Cambridge: Cambridge University Press.

Mauro, P. and Y. Yafeh (2003) 'The Corporation of Foreign Bondholders', IMF Working Paper WP/03/107, Washington, DC: International Monetary Fund.

McNamara, K.R. (1998) *The Currency of Ideas,* Ithaca: Cornell University Press.

Mosley, L. (2000) 'Room to Move: International Financial Markets and National Welfare States', *International Organization* 54: 737-73.

Mosley, L. (2003a) 'Attempting Global Standards: National Governments, International Finance, and the IMF's Data Regime', *Review of International Political Economy* 10: 331-62.

Mosley, L. (2003b) *Global Capital and National Governments*, Cambridge: Cambridge University Press.

Muldrew, Craig (1998) *The Economy of Obligation: The Culture of Credit and Social Relations in Early Modern England*, New York: St. Martin's Press.

North, D.C. (1990) *Institutions, Institutional Change and Economic Performance*, Cambridge, Cambridge University Press.

O'Rourke, K. and J. Williamson (1999) *Globalization and History: The Evolution of the Nineteenth-Century Atlantic Economy*, Cambridge MA: MIT Press.

Palan, R. (2003) *The Offshore World*, Ithaca, Cornell University Press.

Pauly, L.W. (1997). *Who Elected the Bankers?,* Ithaca: Cornell University Press.

Santiso, J. (1999) 'Analysts Analyzed: A Socio-Economic Approach to Financial and Emerging Markets', *International Political Science Review* 20: 307-30.

Santiso, J. (2003) *The Political Economy of Emerging Markets: Actors, Institutions and Crisis in Latin America*, Basingstoke: Palgrave.

Seabrooke, L. (2001) *US Power in International Finance,* Basingstoke: Palgrave.

Seabrooke, L. (2004) 'The Economic Taproot of U.S. Imperialism: The Bush Rentier Shift', *International Politics* 41: 293-318.

Seabrooke, L. (2006) *The Social Sources of Financial Power,* Ithaca: Cornell University Press.

Simmons, B. and Z. Elkins (2004) 'The Globalization of Liberalization: Policy Diffusion in the International Political Economy', *American Political Science Review* 98:171-189.

Sinclair, T.J. (2005) *The New Masters of Capital,* Ithaca: Cornell University Press.

Stiglitz, J. (2002). *Globalization and its Discontents,* New York: W.W. Norton.

Tilly, C. (1992) *Coercion, Capital and European States, AD 990-1992,* Oxford: Blackwell.

Weber, Max (1976) *The Protestant Ethic and the Spirit of Capitalism*, London: George Allen and Unwin.

Weber, Max (1988) *Gesammelte Aufsätze zur Wissenschaftslehre*, Tübingen: J.C.B. Mohr.

Weber, Max (1998) *The Agrarian Sociology of Ancient Civilizations,* London: Verso.

Wilde, O. (1993) *An Ideal Husband,* London: A & C Black.