

Understanding the 2007–2008 Global Financial Crisis: Lessons for Scholars of International Political Economy

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Abstract

Economists have explained the 2007–2008 global financial crisis with reference to various market and regulatory failures as well as a macroeconomic environment of cheap credit during the precrisis period. These developments had important political causes that scholars of international political economy (IPE) should have been well positioned to study before the crisis. How well did they anticipate the crisis? Although none foresaw all the causes, a number of IPE scholars correctly identified many of the dangers associated with new models of securitization as well as accompanying regulatory failures and the politics underlying them. IPE scholars were less successful in identifying the macroeconomic roots of the crisis, particularly the role of international capital flows in fueling the U.S. financial bubble, but some scholars did usefully explore the politics that contributed to the latter phenomenon. The study of IPE scholarship in this episode contains useful lessons for the field's future.

INTRODUCTION

The global financial crisis of 2007–2008 was the most severe since the Great Depression of the 1930s. Some of the world’s best-known financial institutions collapsed or were nationalized, while many others survived only with massive state support. More than any other financial meltdown in the postwar period, the crisis affected major financial centers across the entire world (Reinhart & Rogoff 2009). It also generated a collapse of international trade more severe than any since the 1930s, and a broader economic downturn that involved all regions of the globe.

After listening to economists discuss the crisis during a tour of the London School of Economics in November 2008, Queen Elizabeth II famously asked (*Sunday Times* 2008): “If these things were so large, how come everyone missed them?” Her question crystallized a widespread view that the economics profession largely failed to predict the massive event and had much to learn from its failure. The sentiment has provoked a wide-ranging debate among economists about what specific lessons can be learned from the crisis—that is, how understanding the crisis ought to shape the future direction of their discipline.

A similar debate has begun among political scientists working within the field of international political economy (IPE). Echoing the Queen, Cohen (2009, pp. 437, 436, 440–41, 438) argues that IPE scholars had a “dismal” record in anticipating the crisis, and he compares their “myopia” to the failure of international relations scholars to predict the collapse of the Soviet Union two decades earlier. He is particularly critical of the “American school” of IPE, whose “mid-level theory building” and “reductionist” style of method precluded a focus on structural instability and systemic change. Although some working within the “British school” were more focused on the growing instability of global finance, Cohen argues they too have little to celebrate: “Predictions were loosely framed

and often maddeningly imprecise. Few analysts foresaw the specific sequence of events that unfolded; many were downright wrong about the details; certainly none got the timing right.” This collective failure, in Cohen’s view, should provoke a wide-ranging discussion about the lessons to be learned and the field’s future direction.

Mosley & Singer (2009, p. 420) question whether Cohen’s judgment of scholarly failure is too harsh, since IPE scholars “are generally not in the business of predicting financial crises or recessions.” This may be true, but as Rajan (2010, p. 7) notes, “almost every financial crisis has political roots.” In explaining this latest crisis, he and many other prominent economists call attention to the political dimensions of many of the causes, showing a renewed appreciation for the study of political economy (Sheng 2009, Johnson & Kwak 2010, Roubini & Mihm 2010). Although political scientists working in the field of IPE may not be in the business of predicting financial crises, they should have been well positioned to identify some of these causes in ways that anticipated what was to come. Cohen is right to ask whether they in fact were so positioned and what can be learned from the experience.

In this essay, I explore these questions. Although Cohen is correct that IPE scholars failed to anticipate the causes of the crisis in a comprehensive manner, I argue that the field’s record was not quite as dismal as he initially suggested. Just as the economics discipline contained some individuals with unusual foresight, there were a number of IPE thinkers who identified many of the key sources of the crisis. After briefly outlining the chronology of the crisis, I highlight two complementary sets of explanations put forward in postcrisis economics literature. The first focuses on various market and regulatory failures, whereas the second explores the significance of a macroeconomic environment of cheap credit during the years leading up to the crisis. Both of these developments had important causes that IPE scholars

identified before the crisis.¹ Their analyses, as well as some of the oversights in precrisis IPE literature, provide important lessons for the field, which I summarize in the conclusion.

THE POLITICS OF MARKET AND REGULATORY FAILURES

The crisis of 2007–2008 unfolded in several stages (Roubini & Mihm 2010). It began in the United States with the bursting of a housing bubble and the growth of mortgage defaults, particularly those involving subprime mortgages that had been extended in growing numbers at the height of the bubble to less creditworthy borrowers. These defaults increasingly affected the stability of financial institutions with exposure to these mortgages as well as financial products tied to these mortgages (described below). Several hedge funds were the first to collapse in May and June 2007, and by August, serious concerns broke out in money markets about the exposure of a wide range of financial institutions in the United States and Europe that had invested heavily in mortgage-related financial products. By mid-September, panic even broke out at the retail level, with Britain experiencing its first bank run (Northern Rock) since the nineteenth century.

Despite official efforts to calm the markets with large doses of liquidity, the crisis only deepened in March 2008, when the major U.S. investment bank Bear Sterns had to be rescued by U.S. authorities. Three developments in September 2008 then triggered a total collapse of market confidence. Early in the month, the U.S. government placed the two giant government-sponsored mortgage lending agencies, Fannie Mae and Freddie Mac (“Fannie and Freddie”), under a form of public “conservatorship” because of the enormous losses they were experiencing. By the middle of the month, the U.S. investment bank Lehman

Brothers was forced into bankruptcy. Shortly thereafter, the world’s largest insurance company, American International Group (AIG), was rescued and nationalized by the U.S. government.

It was at this point that the severity of the crisis began to be felt much more strongly beyond the North Atlantic region. Because of their difficulties, U.S. and European banks pulled back their international loans, triggering severe financial problems and debt crises in countries that had been borrowing heavily from abroad. International trade credits also dried up, bringing exports and imports to a standstill in many sectors and countries. Financial contagion was felt particularly strongly in countries whose financial systems were already vulnerable because of home-grown housing bubbles, financial excesses, and/or large current account deficits. Iceland was a particularly dramatic example, but there were many others, such as Britain, Germany, Ireland, Spain, the Baltic countries, Dubai, Singapore, Australia, and New Zealand. The impact of the financial crisis also spread globally through various spillovers operating through the “real economy,” such as collapsing exports, commodity prices, and remittance payments.

Although economists largely failed to predict this global economic seismic shock, they have since made up for their oversight by generating a large and growing literature explaining the crisis. Many economists point to market failures that generated excessive risk taking and a financial bubble during the years leading up to the crisis. Although some of the specific failures were unique to this era, those with a historical perspective have usefully highlighted broad parallels with past crises. Drawing on Kindleberger’s (1978) classic work, they note that financial manias are usually set off by a change in expectations or “displacement,” often caused by some kind of innovation. That innovation then generates overtrading and the emergence of a bubble driven by a kind of excessive optimism and herd behavior. When the bubble eventually bursts, panic ensues.

AIG: American International Group

¹Some of the cited references were published in 2008, but these were generally written and accepted for publication before the outbreak of the crisis.

MBS: mortgage-backed security
CDO: collateralized debt obligation
CDS: credit default swap
OTC: over-the-counter

The Promise and Perils of Securitization

In the case of this latest bubble, the key innovation is widely seen by economists to have emerged in the financial sector itself in the form of new kinds of securitization (Roubini & Mihm 2010). One kind involved privately issued complex mortgage-backed securities (MBSs). MBSs had been pioneered in the United States in the 1970s by the government-sponsored Fannie and Freddie, which had issued simple bonds backed by packages of mortgages they held. But after the early 1990s, the volume of MBSs began to grow rapidly as a wide range of private firms entered the market, offering securities that were structured in increasingly complex ways. After being bundled together, packages of mortgages—including subprime mortgages after 1997—were sliced up by these firms into MBSs with distinct risk profiles that were sold and traded worldwide. The resulting MBSs themselves also began to be divided and repackaged together into new collateralized debt obligations (CDOs) whose cash flows derived from the other bonds.

The rapid growth in the trading of credit risk through these increasingly complex securities was not restricted to mortgages but also included other “asset-backed securities” linked to car loans, student debt, credit cards, and so on. In addition to being divided up and traded through these new instruments, credit risks were also hedged via new kinds of derivatives, most notably the credit default swap (CDS). This product was invented in 1991, and it effectively insured holders of bonds against the risk of default (by offering to pay the buyer of the CDS contract the full value of the bond on which the CDS contract was written in the event of a default). Many buyers of CDSs did not in fact own the underlying bond but simply wanted to speculate on the likelihood of default on specific bonds. A large market was even created before the crisis in CDS contracts based on indexes of bonds. By the end of 2007, the size of CDS contracts had grown dramatically to a gross nominal value of more than \$60 trillion,

a figure larger than the world’s overall gross domestic product (although net exposure was lower because many contracts offset each other) (Financial Services Authority 2009, p. 81). Most of the explosive growth of CDSs and other derivatives during the past two decades involved “over-the-counter” (OTC) products negotiated privately on a bilateral basis between the buyer and the seller.

These new kinds of securitization generated great enthusiasm among market players not only because of the profits to be made but also because of the belief that these new products were boosting the stability and resilience of the financial system as a whole by dispersing risk and deepening markets for risk. Many top regulators and public officials shared this belief. As then-Chairman of the U.S. Federal Reserve Alan Greenspan put it in 2004, “not only have individual financial institutions become less vulnerable to shocks from underlying risk factors but also the financial system as a whole has become more resilient” (quoted in Kapstein 2006, p. 141-2). The crisis raised serious questions about this line of argument.

To begin with, as mortgage lenders increasingly passed on the mortgages they originated (rather than holding them), they began to overlook prudential concerns in their quest to generate fees that came from selling ever larger volumes of loans. As credit risk was transferred to parties far removed from the original source and bundled in increasingly complex ways, its quality also often became more obscure and underpriced. Investors frequently lacked full understanding of complex securities they purchased or the quality of the loans underlying the asset-backed securities in which they invested. They relied heavily on credit-rating agencies, which often issued overly positive ratings because they too found it difficult to evaluate risks accurately and/or because of various conflicts of interest (e.g., they were paid by, and relied on information from, the issuers).

Securitization also increased the number and significance of financial actors who fell outside of traditional prudential regulations covering commercial banks. As defaults on

subprime mortgages began to rise in 2007, the first institutions to collapse were unregulated, highly leveraged hedge funds that had become involved in the trading of some of the riskiest tranches of CDOs. Next in line were various structured investment vehicles created off balance sheet by commercial banks to invest in various complex products and funded with short-term commercial paper issues. As the value of the investments of these “shadow banks” came into question, investors refused to fund the vehicles further. Also suddenly vulnerable were various nonbank mortgage lenders who had funded their loans from investors in MBS products. In addition, the collapse of confidence in mortgage-related securities began to highlight the vulnerability of lightly regulated investment banks, which had become deeply involved in the buying and selling of complex securities and derivatives.

The growing troubles of the large investment banks then highlighted a further problem with securitization: the large-scale buying and selling of complex securities and derivatives had increasingly taken place among a very small number of financial institutions, thereby concentrating risks rather than dispersing them. When Bear Sterns’ troubles escalated in March 2008, the significance of this concentration of risk became clear. U.S. authorities concluded that because of the investment bank’s interconnections with other major institutions via complex securities and CDS contracts, it was too systemically important to be allowed to fail. In September, the demise of Lehman Brothers, a firm that was deeply involved in derivatives and complex securities, confirmed that the collapse of an interconnected investment bank could generate a market meltdown.

The financial difficulties of AIG presented another dramatic example of the concentration of risk in lightly regulated firms within the new securitized world. That institution had sold vast quantities of CDSs without setting aside enough capital or liquidity reserves. In the words of U.S. Federal Reserve Chairman Ben Bernanke, it had ended up acting “like a hedge fund sitting on top of an insurance company”

(quoted in Paulson 2009, p. 236). At the time of its rescue, AIG had more than \$2.7 trillion in notional derivatives exposure from 12,000 contracts, of which \$1 trillion was with only twelve financial firms (Sorkin 2009, p. 236–37). Authorities were forced to recognize that, as Sorkin (2009, p. 394) puts it, “AIG had effectively become a linchpin of the global financial system.”

Securitization contributed to the severity of the crisis in two further ways. First, the huge mountain of securities and derivatives built on U.S. mortgages not only magnified the financial impact of the bursting of the U.S. housing bubble but also spread it worldwide. Approximately half of the MBSs and CDOs created by Wall Street were sold to foreigners, especially European banks and hedge funds (Roubini & Mihm 2010, p. 119). Second, once the crisis broke out, the far-flung diffusion of MBSs and CDOs also intensified the panic because of widespread uncertainties about which institutions actually held these products and what their levels of exposure were. The lack of transparency was only compounded by the opacity of the enormous OTC derivatives markets. At the time of Lehman’s collapse, for example, no one knew the precise size of the CDSs on its bonds or who held these contracts. As Tett (2009, p. 226) puts it, “the CDS market had turned into a vast, opaque spider web of deals in which banks, shadow banks, and brokers alike had become dangerously ensnared, interlinked by fear.”

A major cause of the global financial crisis was thus the transformation in financial systems unleashed by new models of securitization. In the words of Roubini & Mihm (2010, p. 272), “the crisis was less a function of subprime mortgages than of a subprime financial system . . . the global financial system rotted from the inside out. The financial crisis merely ripped the sleek and shiny skin off what had become, over the years, a gangrenous mess.” Although the U.S. financial system witnessed many of the greatest excesses, it is worth emphasizing that the problems associated with securitization trends were not unique to that country’s firms

and markets. Not only were many foreign financial institutions deeply involved in U.S. financial markets, but many other countries—particularly in Europe—had been experiencing similar trends in their own home markets.

What Were the Regulators Doing?

Blame for these developments rests not only with market participants but with regulatory authorities who failed to address the dangers that had been building in the global financial system. The failure was particularly striking because this was an era in which regulators worked intensively to build and strengthen internationally coordinated prudential standards that were designed to create more shock-proof global financial markets. These efforts had begun with the creation of the 1988 Basel Accord, which set out common capital standards for international banks (updated between 1998 and 2004 into “Basel II”). They then accelerated in the wake of the 1994 Mexican and 1997–1998 East Asian financial crises, when policy makers from the G7 countries began to promote the global adoption of international best-practice standards. These standards applied to a wide range of prudential issues relating to bank supervision, securities regulation, insurance, accounting, auditing, payments systems, and corporate governance. In addition, the institutional environment in which international regulatory and financial stability issues were discussed was strengthened with the creation of the Financial Stability Forum (FSF) in 1999. This body brought together in one place for the first time the key international standard setting entities and other national and international officials concerned with financial stability, and it was tasked with anticipating and preventing the accumulation of system-wide risk.

Despite these initiatives, the content of the emerging “international financial standards regime” (Walter 2008) had important limitations. Although common international capital standards were developed for banks, those standards did not apply to the institutions that were becoming more and more systemically

important because of securitization trends, such as investment banks, insurance companies, and hedge funds. Regulators in the United States and Europe also did not rein in banks’ creation of structured investment vehicles, even though these entities enabled evasion of the Basel capital requirements. Both U.S. and European regulators also allowed banks to lower their reserves through the purchase of CDS contracts, despite the fact that many issuers of those contracts—such as AIG—were not subject to the same capital requirements as banks (Tett 2009, pp. 45–49, 60–64).

These weaknesses were part of a broader trend in which regulators increasingly supported more “market-friendly” approaches to regulation that trusted private actors to self-regulate (Porter 2005). In some sectors, such as OTC derivatives, accounting, and hedge fund management, standards developed by private bodies were endorsed by policy makers. In other key areas, such as credit rating, international standard setters developed only voluntary rules for the industry. Even the international standards that encouraged mandatory regulation by national public authorities, such as bank capital rules, increasingly moved in the same direction. In 1996, Basel I was amended to allow large banks to use their internal value-at-risk models to calculate capital charges for market risk. The 2004 Basel II agreement then reinforced this approach, allowing large banks to use internal risk models to determine the amount of capital to put aside for overall credit risk. It also assigned credit-rating agencies a formal role in credit risk assessment for banks and elevated “market discipline” to become one of its three pillars of regulation (alongside formal capital requirements and supervision).

Given the problems accumulating in the markets, these regulatory trends could not have come at a worse moment. The growing reliance of regulators on market-based mechanisms for valuing risk and assets also had dangerously procyclical effects. During the boom, risk valuation models drawing on market prices signaled a relatively low-risk environment and thus encouraged further buying. Once the crisis

began, however, the same models unleashed a vicious downward cycle by prompting mass selling. The new requirements under international accounting rules to use “fair value” accounting have also been criticized for having had the same effect because they forced institutions to value assets at their market value at any given moment.

These international trends were reinforced by various deregulatory initiatives at the national level, of which moves in the United States proved particularly important for the global system (Johnson & Kwak 2010, Roubini & Mihm 2010). In 1999, the U.S. Congress largely repealed the separation of investment and commercial banking that had been established after the Great Depression. This change facilitated the greater participation of commercial banks in the securitization trends and intensified competitive pressures among firms. The next year, Congress locked in a *laissez faire* regulatory environment for OTC derivatives. In 2004, the U.S. Securities and Exchange Commission lifted a 12:1 leverage ratio for investment banks, a move that enabled them to engage in greater risk taking. Finally, in the years leading up to the crisis, U.S. authorities did not do enough to stop the growth of poor mortgage lending practices in the private sector, especially vis-à-vis subprime loans.² The deregulatory trends in the United States were echoed in many other countries, most notably the United Kingdom, which trumpeted its “light-touch” regulatory environment.

IPE Scholarship Before the Crisis

How well did IPE scholars identify the problems being generated by securitization and regulatory trends during the lead-up to the crisis? Particularly prescient was Kapstein (2006), who questioned the conventional

wisdom that securitization was making the global financial system safer in a 2006 article surveying what he called the contemporary “financial risk environment.” Kapstein noted that the opacity of derivatives created risk exposures for financial institutions that were difficult to monitor, and that banks were using CDS contracts to reduce capital requirements in ways that shifted risks to the sellers of the insurance. He also highlighted the new off-balance-sheet risks as well as the potential procyclicality of Basel II in a downturn. In addition, Kapstein argued that increasingly large banks might be generating new risks because of their growing interconnectedness, their managers’ difficulties in monitoring firm activities, too-big-to-fail mentalities, and potential exposure to a housing market collapse. He warned of a possible future crisis involving “the collapse of a trillion dollar institution, with myriad tentacles of complex financial engagements reaching deeply into firms, markets, and households” (Kapstein 2006, p. 148). Such a crisis, he argued, would require a massive bailout involving legislative support. This, in turn, would encourage domestic politicians to become much more interested in regulatory issues than they had been before the crisis.

A number of other specialists in the IPE of finance also anticipated important parts of the story. Strange (1998) warned of a major crisis because global markets were increasingly out of the control of regulators and supervisors. Among other developments, she called particular attention to the dangers posed by the delegation of regulatory functions to private actors in international standards and by the growing opacity of, and leverage within, OTC derivative markets. Before the crisis, Underhill (1995) had also been a longstanding critic of the endorsement of self-regulation in international standards, and, along with some colleagues, he developed a strong critique of Basel II’s procyclicality and its endorsement of internal risk models (Claessens et al. 2008).

Blyth (2003) also criticized the procyclicality of banks’ internal risk models as well as the decision of Basel regulators to give them

²Some also blame the U.S. policy makers for pressuring Fannie and Freddie to buy more subprime loans, but others argue that the growth of subprime lending was mainly underwritten by private lenders rather than these agencies (Johnson & Kwak 2010, pp. 144–46; Roubini & Mihm 2010).

more prominence. He worried too that the complexity of derivatives made risk monitoring particularly difficult, and he predicted that their growth would mean that future crises would be “amplified through the system in unpredictable ways” (Blyth 2003, p. 248). Three years later, a book by Bryan & Rafferty (2006, p. 209) also surveyed the political economy of derivatives and argued that “derivatives have made it likely that any financial crisis will have a more pervasive and speedy impact than was previously the case.” Best (2005) similarly warned about the opacity of derivatives and the links they created across markets. More generally, she expressed skepticism about the trend of “privatizing risk” and supporting market-friendly regulation, highlighting the difficulties for market actors of accurately determining any institution’s risks at any given time.

Other IPE scholars also focused on some of the lightly regulated private actors that were becoming increasingly significant in global markets. Sinclair highlighted how securitization trends were boosting the influence in global financial markets of credit-rating agencies, and he warned about giving them too large a regulatory role given that their ratings were procyclical and often flawed because of conflicts of interest and various biases (King & Sinclair 2003, Sinclair 2005). Harmes (2001a, 2002) also called attention to the growing power of hedge funds and argued that their herd behavior and overleverage could be a source of financial instability and systemic risk. He urged stricter mandatory regulation, arguing that voluntary standards and market discipline were unlikely to constrain their risky activities.

Finally, some IPE scholars also identified the importance of securitization trends in the housing sector before the crisis. Particularly noteworthy was the work of Langley (2006), who called on scholars to pay more attention to growth of the MBS market in the United States and United Kingdom. In an analysis he subsequently expanded in a 2008 book, Langley urged his IPE colleagues to recognize that international capital flows were increasingly linked to the housing-related

borrowing and saving in these two countries. He highlighted how MBSs (and other asset-backed securities) had become major parts of Anglo-American capital markets and described the process by which mortgages were transformed into MBSs and CDOs and spread across the world. He also identified the key role of credit-rating agencies in the process and ways in which banks, such as Northern Rock, were using off-balance-sheet accounting to evade Basel capital rules. Although he did not predict the crisis, he was skeptical of market actors’ claims that they could capture, measure, and manage the risks involved in mortgage lending.

An important characteristic of the work of all these scholars was their willingness to open the “black box” of global finance (Mackenzie 2005) and link the detail found therein back to the big picture of global financial stability. Instead of seeing “global finance” or “capital mobility” in an abstract way or focusing exclusively on macroeconomic outcomes, they called attention to the specific practices and products, institutions and rules, and ideas and cultures that made up global financial markets. This perspective led them to recognize important trends in markets and regulation that more exclusively macro perspectives missed. It also encouraged them to question the claims of neoclassical economics that the markets were perfectly functioning, self-regulating machines. This skepticism was also present among other critics who highlighted the broader dangers of financial deregulation and liberalization, often inspired—as were many of the IPE scholars noted above—by famous past critics of unfettered finance, such as John Maynard Keynes or Hyman Minsky (Kirshner 2003, 2006; Nesvetailova 2007; Palan 2009).

Explaining the Regulatory Trends

IPE scholars not only identified key problems emerging but also offered important political explanations of the trends they saw, particularly the trend toward more market-friendly regulation. Perhaps the most common explanation in precrisis IPE scholarship of the latter was

that it reflected the power of private financial interests at both the national and international levels. Plenty of evidence of private influence pushing in this regulatory direction has been unearthed at the national level, particularly since the outbreak of the crisis (Johnson & Kwak 2010). Before the crisis, a number of IPE scholars also noted the growing capture of international policy-making processes by powerful market players organized in transnational lobby groups (Porter 2005, Tsingou 2006, Claessens et al. 2008, King & Sinclair 2003).

Anticipating many postcrisis popular analyses, IPE scholars also highlighted reasons why financial regulatory policy was particularly prone to “capture” by private interests, such as its complexity, its less obvious distributional consequences (for all but the financial sector), the prevalence of revolving doors between the financial industry and regulators, and an institutional setting in which regulators often had considerable autonomy from domestic politics. A number of analysts also pointed to some larger structural developments that they argued helped to explain the growing political clout of financial interests. One was the heightened mobility of financial capital, which strengthened the structural power of the financial industry in regulatory affairs (Underhill & Zhang 2008). Another was the fact that the financial sector had become an increasingly important source of profit accumulation and growth in capitalist societies since the 1980s, a development that some scholars linked to the exhaustion of the post-war production-centered regime (Bello 2006). Others attributed the growing significance of private standards and self-regulation to a broader weakening of the territorial nation-state and the emergence of a broader post-Westphalian world order (LiPuma & Lee 2004).

To some analysts, these structural explanations of private financial power appear less convincing in the postcrisis era because states have suddenly been tightening regulation over the financial sector at both the national and international levels, including in areas that had largely self-regulated before the crisis, such

as credit rating, OTC derivatives, and hedge funds. Because many aspects of this trend have taken place in the face of the opposition of private financial interests, the influence of the latter now appears to some scholars more contingent on domestic politics and less a product of deeply rooted long-term structural developments (Helleiner & Pagliari 2010, Clapp & Helleiner 2011). As Kapstein (2006) predicted, the massive bailouts in the United States and Europe mobilized domestic societal groups and national politicians to pressure regulators for tighter rules. Although private sector voices had strong influence during the precrisis years of relative financial stability, regulators were now prompted to appease domestic legislative bodies and respond to broader domestic demands for stability in order to preserve their long-term autonomy, prestige, and future job prospects. Instead of seeing regulators as structurally subject to capture, this perspective sees them as “bureaucrats who attempt to resolve conflicting public and private sector interests in such a way as to maintain and enhance their positional power within their domestic political structures” (Kapstein 2006, p. 123; see also Singer 2007).

Alongside the influence of financial interests, precrisis IPE scholarship also attributed the trend toward market-friendly forms of regulation to ideational factors. Analysts highlighted how many top officials genuinely believed, as noted above, that securitization was creating a more resilient and risk-free financial environment. This belief dovetailed with broader triumph of free market ideology after the end of the Cold War and was buttressed by technical economic ideas such as the efficient-markets hypothesis and other aspects of modern finance theory (Blyth 2003, Best 2005, Mackenzie 2006). This cluster of ideological and technical beliefs was particularly strong among U.S. officials, but it was also quite widespread among what Tsingou (2006) calls the “transnational policy community” of experts, technical officials, and private sector actors who dominated international regulatory debates before the crisis. This ideational

context not only generated support for market-friendly regulation at the official level but also helped encourage excessive optimism within financial markets at the time (Reinhart & Rogoff 2009). Some IPE scholars have also explained the latter with reference to deeper ideational influences within Anglo-American culture, such as the discursive power of “risk management” and its link to identities of liberal subjectivity (Langley 2008), as well as the growth of a “mass investment culture” in which members of the general public increasingly associated their own prosperity with that of financial markets (Harmes 2001b, Johnson & Kwak 2010, pp. 104–18).

Finally, some analysts explained support for market-friendly regulation in more statist terms as a U.S.-driven or Anglo-American project. Because of the international importance of their financial markets, the United States and Britain had unique power to determine international regulatory outcomes by controlling access to those markets, implementing unilateral deregulatory moves, and vetoing international initiatives they did not like. They also had strong representation and influence in many of the key international forums in which regulatory issues were discussed. U.S. and British support for precrisis regulatory developments was attributed partly to the strong influence in these countries of private financial interests and the ideational trends noted above. But scholars also argued that policy makers in these states believed that these trends would benefit their states disproportionately. Not only would their powerful firms and attractive markets flourish in a more market-oriented global financial order, but free-flowing capital would be attracted to their territories to help fund current account and fiscal deficits (Blyth 2003, Kirshner 2006, Wade 2007; see also Strange 1986).

Taken together, these three broad political factors—private interests, ideational influences, and Anglo-American power and interests—offered important explanations for pre-2007 global regulatory trends (Blyth 2003, Kirshner 2003). But there was also an important lacuna

in precrisis literature that was revealed once the crisis broke out. Although the crisis was global in scope, there was considerable variation in countries’ experience. As Roubini & Mihm (2010, p. 9) put it, the crisis “was not indiscriminate in its effects; only countries whose financial systems suffered from similar frailties [as the United States] fell victim to it.” The financial systems of a number of countries—including Canada, right next door to the epicenter of the crisis—remained relatively stable through the crisis, and this outcome was widely attributed to regulatory choices made before the crisis. These differentiated experiences highlight the need for more comparative analysis of financial regulatory politics (Mosley & Singer 2009). National financial systems remain regulated in quite distinct ways, despite globalization pressures and the emergence of the international standards regime after the late 1990s (Walter 2008). This kind of comparative work will also help encourage IPE scholars to move beyond the Anglo-American focus of much of the precrisis literature.

To explain precrisis regulatory trends, one final aspect of international regulatory politics deserves more attention: the politics within the FSF. In the wake of the East Asian crisis, many policy makers hoped that this new institution would play a major role in promoting global financial stability. These hopes were clearly dashed, but there is almost no academic literature in IPE (or beyond) explaining why. A thorough analysis of the politics of the FSF is also needed because the G20 leaders have now upgraded the FSF into a more substantial body, the Financial Stability Board (FSB), with a formal charter, more staff, and a strengthened organizational structure. The FSB is being touted by top policy makers as a “fourth pillar” of the international economic architecture alongside the World Bank, International Monetary Fund (IMF), and World Trade Organization (Helleiner 2010). Understanding the history of the FSF, on which the FSB is built directly, will help IPE scholars better interpret the prospects for this institution.

THE POLITICS OF CHEAP CREDIT AND GLOBAL IMBALANCES

Market and regulatory failures were not the only inducements to excessive risk taking during the lead-up to the crisis. Also important in many countries was a macroeconomic environment of cheap credit during the half decade before 2007. In the past, low interest rates have often acted as a catalyst for financial bubbles, encouraging excessive debt accumulation and leverage, as well as the pursuit of riskier investments. They played the same role in this crisis, acting as a kind of fuel that set in motion many of the market processes described in the previous section. Some analysts blame the cheap credit environment solely on domestic policy mistakes made by central banks, such as the U.S. Federal Reserve, which is said to have kept interest rates too low in this period (Taylor 2009). Others, however, take a more international view, focusing on the role of international capital flows and global imbalances. Given their international focus, IPE scholars should have been particularly well placed to study this latter cause. How well did they do?

International Sources of the U.S. Financial Bubble

Let us first examine how international capital flows contributed to the crisis. During the last two decades, financial crises in developing countries were often caused by large inflows of foreign capital, which created cheap credit conditions and contributed to financial bubbles within the country. Many of the countries affected worst by the 2007–2008 crisis had a similar experience during the years leading up to the crisis. Particularly important for the global system was the experience of the United States, which absorbed large amounts of foreign capital before the crisis from various countries in Asia, Europe, and the Middle East with large current account surpluses and high savings.

These capital inflows drove down the cost of credit in the United States, helping to explain

why long-term interest rates and fixed mortgage rates remained low even after the Federal Reserve began to raise the federal funds rate in 2004–2006 (Roubini & Mihm 2010). Capital inflows contributed to the U.S. financial bubble not just at this aggregate macroeconomic level but even in a more direct fashion in the housing sector. Alongside U.S. Treasury bills, the most popular U.S. financial assets for foreign investors to purchase were MBSs, especially the “agency” bonds issued by Fannie and Freddie, which many foreigners assumed to be backed by the U.S. government (Setser 2008, p. 28; Thompson 2009).

Before the crisis, a number of IPE scholars explored the macroeconomic significance of growing foreign investment in the United States. Some even predicted that this situation might generate major global financial instability, perhaps triggered by a U.S. financial crisis (Kirshner 2008) or the bursting of a speculative bubble that was emerging in the U.S. financial system (Dieter 2007). Like most of their economist colleagues (e.g., Eichengreen 2006), however, IPE scholars working in this area anticipated quite a different crisis than the one that ultimately happened. These scholars were more focused on how foreign capital was helping to fund the growing current account and fiscal deficits of the United States, and they considered whether a sudden withdrawal of foreign support could generate a “hard landing” involving a dollar collapse and skyrocketing interest rates (see also Andrews 2008, Cox 2004, Helleiner 2008). From this perspective, the key macroeconomic danger posed by foreign investment was not that it was excessive but rather that it could be insufficient. The domestic U.S. financial bubble was relevant to the analysis only insofar as it might act as a trigger for a collapse of foreign confidence. Although these analyses were right to draw a link between global imbalances and an impending global financial crisis, the crisis that unfolded was caused by too much foreign investment in the United States rather than too little. (The bursting of the U.S. bubble also did not trigger a withdrawal of foreign capital, and it was accompanied by a

dramatic lowering of U.S. interest rates as well as an appreciating dollar, as discussed below.)

The IPE scholars who came closest to identifying the correct causal link between foreign investment and the U.S. bubble were analysts who examined foreign involvement in the U.S. mortgage market. One of these was Langley (2006, 2008), who highlighted how MBSs proved particularly attractive to foreign investors. More important, however, was the work of Schwartz (2007). He identified foreign capital inflows as drivers of the U.S. housing boom in work written before the crisis broke out, which he developed further in his 2009 book *Subprime Nation*. He argued that cheaper credit, induced partly by foreign capital inflows, generated a particularly strong stimulative effect on the U.S. economy because of high levels of home ownership and mortgage debt, as well as the structure of U.S. housing finance, which enabled easy mortgage refinancing.

Neither Langley nor Schwartz predicted the crisis, and neither identified how capital flows drove a broader financial boom involving derivatives and the shadow banking system. But their work was important in identifying one aspect of the link between foreign capital inflows and the U.S. bubble. Their insight stemmed from a common desire to move beyond conventional IPE approaches, which often conceptualized global finance as some anonymous, distant, and abstract force “out there.” That approach had already begun to be critiqued effectively by many of the scholars discussed in the previous section, who studied various actors, institutions, and social practices in the leading global financial markets. Langley and Schwartz went further to show how those global markets were linked to more micro dynamics of domestic financial systems and what Langley (2008, p. 284) calls “our everyday ‘real’ economic practices” of saving and borrowing. This analytical focus led them to see key causal dynamics that others in the field missed. Indeed, before the crisis, most IPE scholars would have considered the details of local housing finance to be primarily a domestic subject beyond the focus of their field.

IPE scholars may have overlooked the ways in which foreign capital inflows were helping to generate an unsustainable financial bubble for two other reasons as well. One was their tendency to discuss the political economy of financial crises in developing countries separately from that in developed countries. Although IPE scholars were very familiar with the role of foreign capital in generating bubbles in developing countries, they failed to extend this understanding to the U.S. situation. Second, the literature on the role of capital flows in developing-country crises had been focused primarily on speculative private capital movements. As I discuss in the next section, however, many of the key investors pumping foreign capital into the United States before 2007 were foreign governments. For those IPE scholars who had become accustomed to blaming private speculators, out-of-control private markets, and “neoliberalism” more generally, this phenomenon was less familiar territory (Helleiner & Lundblad 2008).

Why Did Foreigners Support the United States?

Although they failed to see how global financial flows were generating a U.S. financial bubble, IPE scholars did a better job at exploring the politics that encouraged foreigners to invest so heavily in the United States in this period. Some of the foreign support came from private investors from high-income countries with large current account surpluses, such as Germany and Japan. These countries’ focus on export-led growth has been explained by the structural features of their domestic political economies, such as the power of their export lobbies, political resistance to boosting domestic demand, and the inefficiency of domestically oriented small firms (Rajan 2010, Schwartz 2009). IPE scholars highlighted how private investors from these countries were attracted to put money in the United States in this period because of the dollar’s international role and the unique depth, liquidity, and security of U.S. financial markets, factors that contributed to what Strange (1988) called America’s “structural power” in

global finance (Helleiner 2008, Schwartz 2009). Schwartz (2009) also noted that elite groups in these countries had long resisted the development of financial markets that might compete with those of the United States because they saw bank-based financial systems as crucial to their export success.

What attracted more attention from IPE scholars was the fact that foreign capital flows to the United States also came increasingly from foreign governments in the immediate years before the crisis, most notably those of China, Japan, oil-exporting countries (including Russia), and some other developing economies (particularly in Asia). In the case of oil exporters, the boom in oil prices after 2002 generated surplus funds, which these countries sought to invest securely and profitably in U.S. markets. Some IPE scholars also suggested that the U.S. investments of the oil-exporting Gulf states were tied to their broader security alliance with the United States (Momani 2008). Past IPE scholarship has shown how the dollar reserve holdings of West Germany in the 1960s and those of Saudi Arabia in the 1970s were linked explicitly to broader bilateral security relations with the United States (Spiro 1999, Zimmermann 2002), and some have explained Japan's large dollar reserve holdings in this way as well (Murphy 2006).

Other explanations were put forward to account for the willingness of China and many other developing countries to invest so heavily in the United States during this period. Their investments stemmed from these countries' rapidly growing foreign exchange reserves after 1999, which they recycled into U.S. assets such as Treasury bills or agency bonds. The Chinese case was particularly important because of the speed and scale of the accumulation of its reserves, which increased almost tenfold in a decade to become the world's largest. Before the crisis, China's reserves stood at over \$1.5 trillion (of which approximately 70%–80% was in dollar-denominated assets).

One of the most prominent political explanations of the accumulation of dollar reserves by China and other developing countries

before the crisis was in fact developed by three economists: Dooley, Folkerts-Landau, and Garber. They argued that these countries' policies were driven by their goal to promote rapid export-oriented industrialization. In order to boost the competitiveness of their countries' firms, governments maintained undervalued exchange rates by accumulating foreign exchange reserves. Those reserves were then strategically recycled into U.S. assets in order to help keep their major foreign market economically healthy enough to continue purchasing their exports. These economists drew a parallel to the reserve accumulation of many Western European countries and Japan during the 1960s under the Bretton Woods exchange rate system (Dooley et al. 2003).

A number of IPE scholars endorsed this "Bretton Woods II" explanation for reserve accumulation, and some refined it to highlight the domestic Chinese interests that were served by the arrangement. Instead of assuming Chinese policy makers were pursuing their country's "national interests," Schwartz (2009) argued that it was necessary to look at the interests of the Communist Party elite who derived private profits from their control—or their children's control—of export industries, while deflecting to the mass public the costs of U.S. support (e.g., losses on dollar holdings, inflationary pressures). Hung (2008) also pointed out the role of the powerful coastal export sector in backing the country's exchange rate policy.

Others interpreted the rapid growth of reserves as a tool to preserve national political autonomy in the wake of the traumatic 1997–1998 East Asian financial crisis. From this perspective, policy makers sought to build a war chest of reserves to defend themselves against volatile capital flows as well as dependence on the IMF, whose role in the crisis was widely seen in the East Asian region as unhelpful, too intrusive, and overly influenced by U.S. policy makers' goals (Bowles & Wang 2006, p. 247; Cohen 2008a, p. 461; Setser 2008, p. 19; Wolf 2008). This desire for "self-insurance" generated what Rajan (2010, p. 82) called a "supercharged export-led growth strategy" to earn

foreign exchange. U.S. assets were particularly useful for the reserve function given the dollar's role as the world's most widely used currency. From this more nationalist perspective, the holding of U.S. assets might also have been driven by the objective of cultivating some leverage over the United States. Although the Bretton Woods II theorists spoke of the "mutually beneficial gains" involved in the United States' relations with its major creditors (Dooley & Garber 2005, p. 148), more nationalist views agreed more with Larry Summers' description of it as a "balance of financial terror" (Thompson 2009; Cohen 2008a, p. 462).

From the self-insurance perspective, then, reserve accumulation reflected countries' growing distrust of the international system, a distrust only compounded by the absence of serious governance reform at the IMF and the exclusion of these countries from key international financial standard-setting bodies and the new FSF. IPE scholars have not attempted to systematically evaluate the accuracy of the self-insurance perspective against the Bretton Woods II hypothesis, and this would be a difficult task because the two goals reinforced each other in ways that may be difficult to disentangle. Was reserve accumulation a byproduct of the goal of boosting exports, or was the push for export growth serving the goal of boosting reserves? The relative importance of these motivations undoubtedly differed across countries and may have changed over time. The advantage of the self-insurance story, however, is that it explains why reserve growth suddenly grew sharply after 1999. Recent statistical work by economists also suggests strong support for this explanation (Obstfeld et al. 2010).

IPE scholars also suggested one final motivation for reserve accumulation that may have become more important as time went on, particularly in the case of China. As its reserves grew ever larger, Chinese policy makers were forced to recognize that any initiative to diversify reserves risked triggering market reactions that undercut the value of their country's remaining massive investments (Andrews 2008, Cohen 2008a, p. 462). With its claims on the

United States equal to approximately one third of the Chinese gross domestic product by the time the crisis broke out, China may have been increasingly subject to what Kirshner (1995) called a kind of "entrapment," with its fate increasingly tied up with that of the dollar.

What About the Costs?

Although there were various benefits to official reserve accumulation (as explained by geopolitical, Bretton Woods II, self-insurance, and entrapment interpretations), there were also important costs that IPE scholars highlighted in the lead-up to the crisis (Dieter 2007, Helleiner 2008, Kirshner 2008; see also Eichengreen 2006). As foreign reserves grew in size, they risked generating inflationary pressures because of the difficulties of sterilizing them. The value of reserves was also eroded by the dollar's depreciation after 2002, a depreciation that looked likely to continue given the external debt and current account deficits of the United States. As the costs of reserve holdings grew, analysts also highlighted the risk that some reserve holders might be tempted to be the first to sell in order to minimize their losses before others made the same move, a dynamic that could generate a herd-like selling of the dollar. Such a disorderly dumping of dollars seemed all the more likely because of the existence of a new attractive alternative reserve currency, the euro, and the absence of the kinds of alliance ties and intergovernmental networks of officials that had worked to contain this kind of behavior during the Bretton Woods period. Indeed, some analysts highlighted the possibility that countries dissatisfied with U.S. foreign policy might be tempted to sell reserves for strategic reasons, a possibility that Johnson (2008) suggested was already under way in Russia before the crisis.

It was these risks that led to the predictions of a possible dollar collapse noted above. Those predictions anticipated that major creditor countries might soon judge these costs to be higher than the benefits of holding large dollar reserves. In the end, however, creditors held the opposite view—by a large margin. The danger

to the United States before 2007 was not a foreign pullout but rather foreigners' excessive enthusiasm for U.S. assets. The crisis that broke out was a product of the fact that creditors were too generous rather than too frugal.

Even once the U.S. financial crisis broke out, there was no foreign withdrawal, despite worries among analysts and policy makers at the time. In most emerging-market countries over the previous two decades, the bursting of domestic financial bubbles was accompanied by capital flight, which only exacerbated these countries' financial crises by generating exchange rate depreciation and higher interest rates. But foreign funding of the United States—both public and private—continued during the crisis, even as the United States lowered interest rates dramatically. Indeed, the dollar even strengthened as the crisis became more severe after mid-2008. This outcome prevented the crisis of 2007–2008 from being even more severe than it was both for the United States and for the world economy as a whole.

IPE scholars have not yet produced detailed explanations for the foreign support provided during the crisis. Future scholarship may discover that it reflected the geopolitical, Bretton Woods II, self-insurance, and entrapment considerations discussed before the crisis. But it seems very likely that one of the most important explanations was the structural position of the United States in global financial markets. Despite the enormity of the U.S. financial troubles at the time, the U.S. Treasury bill remained the investment of choice for financial institutions and investors scrambling for liquidity and security in the midst of the panic (Reinhart & Rogoff 2009, p. 222). This development highlighted not only America's structural power but also the failure of the euro to inspire more confidence. The euro's problems were caused by its weak political foundations, a fact that several IPE scholars had highlighted before the crisis (Cohen 2003, Pauly 2008). Because the Maastricht Treaty had failed to specify mechanisms for the prevention and resolution of euro-zone financial crises, national governments across Europe scrambled to support distressed firms

in an ad hoc and uncoordinated manner, leading markets to wonder whether the integrated financial space and monetary zone might unravel. The lack of a single fiscal authority also prevented Europe from developing a financial market that could challenge the U.S. Treasury bill market as the key fulcrum of global financial markets.

The U.S. Side of the Story

If there were a number of possible reasons why foreigners exported such large volumes of money to the United States in the years leading up to the crisis, why did the United States accept the money given the dangers that it posed to its financial system? Some analysts have suggested that the United States in fact had little choice, that it was essentially a victim of the choices of foreigners to send their money to the United States. This view often draws on a famous 2005 speech by Ben Bernanke in which he attributed the growth of U.S. current account deficits and capital inflows to excessive savings in the sending countries (Wolf 2008). But efforts to cast the United States as a passive victim in the face of a "global savings glut" overlook the role of U.S. macroeconomic and regulatory policy mistakes in contributing to its own financial crisis (Roubini & Mihm 2010, pp. 249–50; Stiglitz 2010, p. 9; Taylor 2009). They also neglect the involvement of the United States in mediating and encouraging foreign capital inflows, through its Treasury bill sales and the role of Freddie and Fannie in creating a global market for securitized mortgages (Gotham 2006), as well as through its broader support for global financial liberalization. More generally, Reinhart & Rogoff (2009, p. 209) note that analysts need to explore why U.S. authorities during the bubble years did not ask themselves: "Can there be too much of a good thing?"

Reinhart & Rogoff (2009, p. 213) themselves see the U.S. policy stance as reflecting an ideational complacency—or even "conceit"—among top U.S. policy makers who believed that their "financial and regulatory system could withstand massive capital inflows on a

sustained basis without any problems.” Before the crisis, IPE scholars such as Walter (2008) also noted this overconfidence in the superiority of the U.S. financial system during this period. Walter argued that it was boosted particularly by the East Asian financial crisis, which encouraged U.S. policy makers to see their financial system as a model for the world (see also Johnson & Kwak 2010, pp. 40, 55). The prominence of a *laissez-faire* approach to financial regulation noted in the previous section also contributed to the U.S. complacency.

Like other past experiences of emerging-market countries, capital inflows also served many U.S. interests. Financial firms benefited from being at the center of what Schwartz (2009) calls the “global arbitrage,” selling securities to foreign investors (Setser 2008, p. 26). The housing-led boom was popular at a mass level among Americans, for whom home ownership served as a key means for building personal wealth, particularly in an era of growing inequality and economic insecurity (Rajan 2010, Seabrooke 2006). In the political arena, foreign capital helped to fund ballooning fiscal deficits generated by tax cuts and increased defense spending during the Bush administration. The Bush administration’s strategy of relying on foreign capital to live beyond its means was not unique to this era; IPE scholars have long noted a shift in U.S. policy since the 1960s toward what Gilpin (1987) called a more “predatory” form of hegemony to fund fiscal and current account deficits. The difference in this period was that some of the sources of foreign support shifted (Calleo 2009, Cox 2004).

There was thus a strange complementarity between political developments within the United States and those within the major creditor countries that encouraged large sums of capital to flow from the latter to the former during the years leading up to the crisis. Supercharged export-led growth strategies of governments in the creditor states were complemented by American fiscal overstretch and official complacency in the wake of the East Asian crisis. At the societal level, export-oriented interests in the former found common

cause with Wall Street and home-buying Americans. At a more structural level, financial repression within most creditor states found its perfectly matched opposite in the uniquely deep and liquid U.S. financial markets. And hovering over the entire politics of global imbalances in this period were some geostrategic relationships between the United States and its creditors, which may have come into play.

In summary, IPE scholars may have not foreseen the mechanism by which global imbalances would generate a crisis, but some of them did develop insights about the politics that generated and sustained the imbalances before the crisis. There remains, however, much more to be explored on this topic. More detailed research is needed into the politics of reserve accumulation before the crisis in order to adjudicate between geopolitical, Bretton Woods II, self-insurance, and entrapment explanations. We also need a better understanding of the distributional politics within the United States during this period, particularly of the domestic losers from capital inflows (e.g., some manufacturing sectors) and why their voices were so little heard. Work that compares the U.S. experience with those of many developing countries that experienced bubbles in previous decades might be particularly insightful for this purpose (Sheng 2009). More analysis is also needed of the politics within other countries receiving large inflows of foreign capital in this period, which generated similar, though less systematically significant, bubbles as that in the United States (Seabrooke & Schwartz 2008).

One final issue that needs to be addressed is why more leadership was not forthcoming from the one multilateral institution that has a mandate to tackle the issue of global imbalances: the IMF. Under the original Bretton Woods system, the IMF had been given a mandate to encourage countries to “shorten the duration and lessen the degree of disequilibrium in the international balances of payments of members.” After the Bretton Woods exchange rate regime broke down in the early 1970s, the IMF’s role in this area faded. But one year before the outbreak of the 2007–2008 crisis,

the IMF attempted briefly to play a leadership role in this area, hosting a “multilateral consultation” process that involved China, the euro area, Japan, the United States, and Saudi Arabia and was designed to address global imbalances. In the end, this initiative had little impact and it has received little attention from IPE scholars. But this outcome needs to be explained because it was an important “nondecision” (Strange 1986, 1998) in the history of the causes of the crisis.

CONCLUSION

How well did IPE scholars anticipate the global financial crisis of 2007–2008? It is certainly true that no IPE scholar predicted its timing, its details, and its causes in a comprehensive manner. But the record of the field was not entirely dismal during the years leading up to the crisis. A number of IPE scholars correctly identified many of the key market and regulatory failures that ended up contributing to the crisis. They warned about many of the dangers associated with securitization, such as risk practices in mortgage securitization, the perils of relying on credit rating agencies, the growing systemic significance of unregulated or lightly regulated firms and sectors, the amplification of crises across markets and countries, the opacity of OTC derivatives, and the concentration of risk in large and interconnected firms. In the regulatory realm, they critiqued authorities for failing to update regulations to take account of many of these dangers and for relying more generally on market-friendly forms of regulation. They also developed analyses of political causes of regulatory trends, arguing that they reflected the power of private financial interests and ideational trends as well as U.S. and British power and interests.

IPE scholars were less successful in identifying the more macroeconomic causes of the crisis, particularly the role of international capital flows in helping to generate the U.S. financial bubble. But a number of scholars did usefully explore the politics that contributed to this phenomenon, notably the

complementarity that existed (*a*) between financial repression in creditor countries and U.S. structural power in global financial markets, (*b*) between turbo-charged export-led growth strategies and U.S. fiscal overstretch and regulatory conceit, and (*c*) between export interests in surplus nations and America’s Wall Street and home-buying citizens. Some predicted that the growing global imbalances might generate a global financial instability, but they incorrectly anticipated a dollar crisis because of their judgment that the politics supporting reserve accumulation in creditor states were quite fragile. Political support for reserve accumulation proved instead to be too robust. This was a misjudgment—one echoed by many economists—but hardly a case of “myopia.”

What lessons can be learned for the future of the field of IPE from the record of IPE scholarship in anticipating the crisis? Cohen (2009) suggests that IPE’s poor record in anticipating the crisis highlights the need for a major shift in direction at an epistemological level. He is particularly critical of the epistemology of the “American school,” which emulated neoclassical economics with its reductionist assumptions and rationalist modeling, thereby discounting the possibility of major systemic change. He calls on members of this school to consider more historical, institutional, or interpretive kinds of analysis, and he urges them to read more widely in the “British school” tradition, which has embraced that approach. Reinforcing this point is Palan (2009), who argues that the British school was much more successful in seeing the crisis coming, and he attributes this to its greater focus on history and structural change, its greater skepticism of neoclassical economics, and its more empirical and inductive orientation.

In some respects, my analysis suggests a similar conclusion. Far more of the articles I have cited were published in what these authors consider British school journals than in their American school counterparts. A number of the authors I have mentioned are also ones that Cohen and Palan associate with the British school. Indeed, it is striking that the two senior

scholars whom Cohen sees as pioneering the British school—Susan Strange and Robert Cox—each frequently called attention to financial fragility as a major structural feature of the global political economy during the years preceding the crisis. Interestingly, the British International Studies Association’s IPE Group also awarded its annual book prize in 2007 to a detailed analysis of the new centrality of derivatives markets in global finance: Mackenzie’s (2006) *An Engine Not a Camera*.

At the same time, however, a number of the scholars whom I have cited were also trained and/or inspired by many of the thinkers Cohen (2008b) describes as founders of the American school, not least of whom is Charles Kindleberger. These are scholars who have not embraced the more recent trends in the American school toward rationalist modeling and remain committed to the broader approaches to the field that the founders of the American school themselves embraced at the time of its creation. Many of these scholars now seem to be positioned in a kind of “missing middle” category (Ravenhill 2008) between the newer American school approach and that of the British school—what Katzenstein (2009) describes as a “mid-Atlantic” position. Although the “American versus British school” typology thus raises some questions, the literature described in this essay does suggest support for Cohen’s endorsement of more historical, institutional, and/or interpretive methods.

Does the experience of scholarship before the crisis suggest support for some of the other more traditional intellectual divides in IPE? Looking at the list of scholars I have cited, it is striking that representatives of many of the big paradigms, such as liberalism, realism, Marxism, constructivism, and poststructuralism, all had important insights. So too did scholars on both sides of other divides, such as those between systemic and domestic perspectives or between structuralist and agency-centered approaches. The record of precrisis scholarship thus makes a strong case for analytical eclecticism (see also Cohen 2009, Katzenstein 2009). And included in this eclecticism should be an

openness from political science IPE scholars to insights from economists (who developed important political economy explanations before the crisis, and have done so even more after the crisis) as well as from scholars in other disciplines.

In addition to these general methodological points, the crisis has also obviously strengthened the case for IPE scholars to pay more attention to the study of global finance. For those who are already specialists in this area, I have highlighted some more specific lessons that emerge from the precrisis literature. One is the importance of opening the black box of global finance to explore the specific practices and products, institutions and rules, as well as ideas and culture that make up global markets. Second, more attention needs to be paid to the links between global markets and financial practices at more local and everyday-life levels. Third, IPE scholars need to be careful not to assume that “capital mobility” is always driven by private actors, since many public authorities are playing increasingly important roles as investors in global markets.

I have also highlighted some issues that require more research if we are to gain a fuller understanding of the causes of the financial crisis itself. Much more comparative work—particularly outside of the Anglo-American context—is needed to understand how countries experienced the crisis in quite different ways because of distinct regulatory regimes, different political responses to capital inflows, and unique patterns of integration in the global economy. Some precrisis understandings of private “capture” of regulators also may need to be re-evaluated in light of postcrisis trends. To better understand the growing global imbalances in the pre-2007 period, more research is required into the politics of reserve accumulation in major creditor states. The distributional politics within the United States during this period also needs further study, particularly in a comparative context that includes the experience of developing countries over the past two decades. In addition, at the multilateral level, IPE scholars should explore the politics of the

FSF's functioning during its first decade as well as the failure of the IMF's 2006 multilateral consultation exercise.

Finally and more generally, scholars might consider developing more comprehensive analytical tools to explain global financial crises from an IPE perspective. Because crises on the scale of the 2007–2008 crisis happen so rarely, IPE thinkers have not spent much time trying to develop these tools. If they had, the field might have avoided the situation where a number of IPE scholars identified partial causes of the crisis of 2007–2008 without anyone recognizing the whole picture. In particular, few scholars succeeded in drawing together the politics of the macro story of the global imbalances with the politics of the micro-level market and

regulatory failures. The best-known analytical tool that IPE scholars have to explain major system-wide financial crises is the one developed by Kindleberger (1973) to explain the last global financial crisis of this scale: the Great Depression of the 1930s. But his “hegemonic stability theory” was really more a theory to explain how existing crises could be prevented from spiraling out of control through leadership activities such as maintaining open markets, encouraging counter-cyclical long-term capital flows, and acting as an international lender of last resort. The development of a more comprehensive understanding of the political economy of the underlying causes of global-scale financial crises remains an important task for future IPE researchers.

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