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Keeping governments out of politics: transnational securities markets, regulatory cooperation, and political legitimacy

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We don't deal directly with national governments . . . we did not want to make this a political organisation. . . . [W]e felt if there was a governmental international organisation, then we would get involved in all the politics of the government instead of dealing with the issues . . .

So you want to keep the governments at bay?

They want to keep their governments at bay, most members.

Paul Guy, Secretary General of IOSCO
Interview, Montreal, 10 December 1991

Introduction

The emergence of transnational markets in securities issuance and trading is a dramatic development in the contemporary financial services sector with larger consequences for national policy-making. The liberalization of access to domestic securities exchanges, the progressive reduction of regulatory restrictions leading to product innovation such as derivatives trading, the growing involvement of transnational banks in securities dealing, and the elimination of capital controls have all combined to yield rapid change over the past fifteen years. The process is, however, relatively poorly researched. Folklore about the global markets abounds but much remains to be done to put the global integration of the markets into perspective and understand its complexity. Specifically, there has been a failure to analyse the consequences of the liberalization and transnationalization of financial markets for democratic political systems in an increasingly global market economy.

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In this sense, what might be referred to as the 'political economy of liberalization' with regard to capital markets is at present poorly understood. The debate has largely been dominated by economics literature emphasizing the greater efficiency of liberalized capital markets in the international domain. The debate on the question of regulation is largely carried out between players in the market and regulators which see the issue as a technical matter. The institutional framework of the market is seldom seen as a contestable political institution affecting the politics of who gets what at domestic and international levels of analysis.[1] This paper will somewhat correct the balance and constitutes a case study to support a broader argument about the effects of capital mobility and financial market liberalization on national policy-making processes. While the relationship of the securities sector to other aspects of the financial services industry will be borne in mind,[2] this paper will be primarily concerned with securities markets and will not attempt to address the political and economic problems related to the interlinkages among the various segments of the financial services sector.

The focus will be on the work of the International Organisation of Securities Commissions (IOSCO), the principal international body involved in negotiations leading to the transnationalization of securities transactions and the provision of a regulatory framework for these markets. In brief, the paper will argue three interrelated points. The first is that the accelerating international mobility of capital, in large measure a consequence of transnational financial market integration, has important repercussions for the formulation of national policy objectives. Capital mobility is a significant constraint on state autonomy in domestic macro-economic policy-making.[3] Consequently, the ability of democratic states to make strategic choices concerning the character of their respective societies, along the lines of post-war 'national capitalism', is limited. This has consequences for the legitimacy of governments chosen through democratic processes as they confront the pressures of globalization. The increasing 'marketization' of the international financial order places considerable obstacles in the path of national governments in the definition and execution of their policy choices.[4] Control over economic choices flows to the most successful market actors, principally transnational firms, in a more market-

[1] See Geoffrey R. D. Underhill, 'Conceptualising the Changing Global Order', in Richard Stubbs and Geoffrey R. D. Underhill, *Political Economy and the Changing Global Order* (London, 1994), pp. 19, 29, 33.

[2] The desegmentation of the financial services sector is an important trend, wherein the lines of demarcation between banking and securities activities have become considerably blurred. This trend is characterized by the twin processes of *securitization* of the banking industry (meaning the growth of negotiable credit instruments or 'commercial paper' in banking), and *disintermediation* (meaning the decline of the traditional role of banks as intermediaries between borrowers (bank clients) and lenders (bank depositors), a role replaced by 'securitized' debt instruments as referred to above). In this sense, many banking activities result in tradeable securities being produced, the decline of traditional loan portfolios, and the move of bank assets *off-balance sheet*. For details, see for example Ralph C. Bryant, *International Financial Intermediation* (Washington, DC, 1987).

[3] See Michael C. Webb, 'International Economic Structures, Government Interests, and International Coordination of Macro-economic Adjustment Policies', *International Organization*, vol. 45, 3 (1991), particularly the discussion on pp. 313–21.

[4] The problems of the French Socialist government in 1982–3 as it attempted to define distinctive policies in the wake of a substantial election victory are well-known. Capital flight was one of the principal problems which was encountered in this regard; Eric Helleiner, 'States and the Future of Global Finance', *Review of International Studies*, vol. 18, 1 (1992), p. 34.

oriented order underpinned by an enhanced mobility of capital.[5] The structure of the market is inherently contestable in domestic and international political economies. This implies that changes in the economic order, such as transnationalization and marketization, have distributional consequences—implications for the politics of 'who gets what'—within national societies and among states in the global system. In sum, capital mobility and transnational market integration *do* make a difference, in distributional terms and with respect to national policy-making autonomy; the emergence of transnational securities markets is an important element of this process.

Secondly, the nature of the IOSCO policy process—combined with the constraints imposed on national policy-makers by enhanced capital mobility—suggests an *additional* problem of political legitimacy. IOSCO is a non-governmental institution in the international domain. The securities industry has a long self-regulatory tradition in many states. The lines of democratic accountability for the decisions taken are therefore less than clear. Important decisions about the structure of international capital markets are being taken by non-state bodies outside the traditional legislative process. Yet it has been argued above that the consequences of these decisions are rather far-reaching. They affect the structure of markets and therefore the distribution of relative costs and benefits among social groups and states in the system, a point which will be explored with specific reference to the securities sector but has more general relevance. They affect the capacity of governments to shape their societies in line with preferences expressed in the democratic process. Furthermore, the decisions made in this relatively 'unaccountable' policy process are often aimed at increasing the levels of transnationalization and marketization of economic decision-making, compounding the problem and placing crucial economic choices yet further out of reach of national policy-makers.

These two arguments can be combined and carried a step further. Markets, and the powerful role they imply for business enterprises in the making of political economic choices, pose an accountability problem in and of themselves. When markets become largely transnational, the accountability of market actors to political authorities is even less clear. The original post-war 'Bretton Woods' agreement was designed to attenuate this problem and put economic management in the hands of domestic and international public institutions. The transformation of the international financial system since the 1970s has undermined this system of public management of capital flows and international payments.[6] The IOSCO process aims to extend transnationalization, which means that international cooperation of some sort, with all its attendant difficulties, must fill the regulatory gap created by

[5] Susan Strange discusses this at length in *Casino Capitalism* (Oxford, 1986); see also 'Interpretations of a Decade', in Loukas Tsoukalis (ed.), *The Political Economy of International Money* (London, 1985), pp. 1–43.

[6] See Eric Helleiner, 'From Bretton Woods to Global Finance: A World Turned Upside Down', in Stubbs and Underhill (eds.), *Political Economy and the Changing Global Order*, pp. 163–75; David T. Llewellyn, 'The Role of International Banking', in Tsoukalis (ed.), *Political Economy*, pp. 203–32; Marcello de Cecco discusses in detail the mechanisms of public control of capital movements and how they became undermined in the Bretton Woods order in 'Origins of the Post-War Payments System', *Cambridge Journal of Economics*, no. 3 (1979), pp. 49–61.

'supranational money'[7] and manage the problem of increased volatility. In the absence of political authority over the market, the international economic order may become incompatible with the domestic political and economic stability of important states in the system. This was, after all, the fundamental problem with the international Gold Standard in the interwar period.[8] The advance of US protectionism may be part of this sort of phenomenon.

The third point is that there is still a long way to go in terms of the transnationalization of securities markets. While short-term capital flows in the form of foreign exchange markets are extremely mobile, long-term capital is less so.[9] If this is true, as the paper will demonstrate, then in view of the first two points above it is important that careful consideration be given to both the extent of transnational liberalization and the substance of regulatory reform than has hitherto been the case. The work of IOSCO is aimed at both facilitating this process of transnationalization, and dealing with the related regulatory and supervisory issues. IOSCO is involved in designing the structure and regulation of markets across borders wherein, historically, national systems of regulatory control have prevailed.

The paper will deal with these arguments in three main sections. The first section will explore the relationship between capital mobility, constraints on national policy-making autonomy, and political legitimacy, with some reference to distributional questions in this general context. The second section will look specifically at securities markets in order to establish that in the domain of securities there is still some way to go in terms of transnationalization. This will involve analysis of the characteristics of securities markets, their regulation, and the process of transnationalization. The section will then focus on the work of IOSCO in detail in relation to the arguments outlined above. This will begin by exploring the nature of the IOSCO policy process and move on to discuss the work of the organization with respect to the two examples of international equity offers and capital adequacy. The section will demonstrate that there is a problem of accountability in the policy process which exacerbates the problem of political legitimacy referred to in the section on capital mobility, and that there are attendant distributional consequences for a number of market players inherent in these structural market changes. A final section will tie these points together to establish that the process of transnational 'marketization', which results from liberalization processes, particularly in the domain of financial markets, presents a general challenge to democratic states.

Transnational markets, national policy-making autonomy, and political legitimacy

This paper seeks to build on earlier work which argues that the emergence of

[7] A term used by Howard Wachtel in *The Money Mandarins: The Making of a Supranational Economic Order* (rev. edn., Armonk, NY, 1990).

[8] See discussion by Fred Block, *The Origins of International Economic Disorder* (Berkeley, 1977), introduction, esp. pp. 4–10.

[9] See Jeffry A. Frieden, 'Invested Interests: the Politics of National Economic Policies in a World of Global Finance', *International Organization*, vol. 45, 4 (1991). On p. 428 he argues that capital mobility is still far from perfect, and on p. 429 he states: 'Equity markets in particular appear to be far less integrated [than bonds or bank claims] . . .'

financial markets in the international domain does not represent the spontaneous pattern of exchange of economics textbooks. Instead, the market is conceptualized as a political institution among others, albeit with its own specific dynamics depending on the sector and regulatory framework involved.[10] This is particularly true in that the process of developing transnational markets involves change from one set of essentially nationally-based institutions, with a particular balance of costs and benefits for the actors involved, to another more trans-national pattern representing a change in the distribution of gains and losses. At the very least, a considerable period of adjustment to new competitive pressures would be necessary. Transnational markets also affect the role and capacities of states in the management of the political economy. With respect to the case of securities markets, as will be shown below, protected national and local securities exchanges, often with self-regulatory cartels of brokerage firms focused largely on issuance and secondary trading of local securities (and therefore vital to the local process of capital formation/investment), may be absorbed into larger international financial conglomerates, as was the case with London's 'Big Bang'.[11]

In this sense, the emergence of transnational financial markets is not simply a rational choice leading to greater efficiency for capital formation in the global economy. The creation of these markets is part and parcel of political decision and non-decision making by states and other actors—either domestically or within the framework of responsible international organizations. As such, the creation or extension of market structures in the international domain within a negotiated framework represents a decision to confer relative advantages upon some as opposed to others. The establishment of market institutions which extend across borders, and the resulting enhanced mobility of capital, is part of the politics of who gets what, when, and how.

There is little doubt that capital mobility is increasingly a feature of the global economic order.[12] Capital mobility has developed not only as a result of the liberalization of capital flows by governments since the 1970s but also as a result of the integration of financial markets and the activities of financial institutions across borders. There is also considerable literature which establishes the effects which

[10] G. R. D. Underhill, 'Markets beyond Politics? The State and the Internationalisation of Finance', *European Journal of Political Research*, vol. 19 (1991), pp. 197–225, and 'Negotiating Financial Openness: The Uruguay Round and Trade in Financial Services', in Philip G. Cerny (ed.), *Finance and World Politics: Markets, Regimes, and States in the Post-Hegemonic Era* (Aldershot, 1993), pp. 114–51. The argument in these papers owes a considerable debt to Karl Polanyi, *The Great Transformation*, (Boston, 1944). See also Underhill, 'Conceptualising the Changing Global Order', in Stubbs and Underhill (eds.), *Changing Global Order*.

[11] See Susan Hart, 'National Policy and the Revolution in International Banking: the British Response 1977–1986', unpublished PhD dissertation, London School of Economics and Political Science, August 1989.

[12] See International Monetary Fund, *International Capital Markets, Part I: Exchange Rate Management and International Capital Flows* (Washington, 1993), pp. 1–7.

capital mobility has on state capacities to control the national economic space and make crucial macro-economic and other policy choices.[13]

In the first place, and although the performance of individual countries has diverged somewhat, considerable macro-economic instability may be noted in terms of high real interest rates, unstable performance of national economies in terms of growth over time, balance of payments volatility, and a general decline in savings rates.[14] This may be understood as the instability associated with 'embedded financial orthodoxy' linked to the globalization of finance and associated capital flows.[15] Mobile capital also limits the ability of governments to make independent macro-economic decisions concerning fiscal, monetary, and exchange rate policy. Interest rate differentials linked to attempts by governments to affect domestic macro-economic conditions can lead to perverse and contradictory results.[16] The rise of the Euromarkets and associated short-term capital flows were largely responsible for the breakdown of the old Bretton Woods fixed exchange rate system and the subsequent increase in exchange rate volatility since the 1970s,[17] and exchange controls have been rendered essentially ineffectual.[18] All of this has put considerable pressure on states to cooperate to realize macro-economic policy goals in view of reduced policy-making autonomy linked to changes in the financial system. This means, however, that states must further compromise their domestic autonomy in the name of effective cooperation. Furthermore, in order to be effective, international policy coordination must involve more than 'external' adjustment policies through the exchange rate, to include fiscal and monetary policies: 'a much more intrusive type of policy coordination, since it demanded that governments alter macro-economic policies central to their domestic political programmes'.[19] Finally, the dynamics of 'regulatory arbitrage' have put pressure on states to relax restrictions on economic activities through deregulatory policies in a number of sectors, to reduce corporate

[13] It has been argued in a number of quarters that the emergence of international financial markets represents an important change in the structure of the global political economy. Susan Strange argued the importance of changes in the financial system in *Casino Capitalism*, and she has long argued that the monetary and financial order is the most important factor underpinning the nature of international economic interdependence. More recently, Eric Helleiner has argued the crucial nature of changes in the post-war financial system: see Eric Noel Helleiner, *States and the Reemergence of Global Finance: From Bretton Woods to the 1990s* (Ithaca, 1994). See also John B. Goodman and Louis W. Pauly, 'The New Politics of International Capital Mobility', *International Business and Trade Law Papers*, no. 29 (Toronto, 1991).

[14] With regard to Europe these points were made clearly by Marianne Bliman, Catherine Bruno, and Jacques Le Cacheux in, 'L'Espace bancaire et financier européen', *Observations et Diagnostics Economiques* (Revue de l'Observatoire Français des Conjonctures Economiques), 1993, pp. 198–201.

[15] See Philip G. Cerny, 'American Decline and the Emergence of Embedded Financial Orthodoxy', in Cerny (ed.), *Finance and World Politics*, pp. 155–85.

[16] See Webb, 'International Economic Structures', pp. 318–19, and discussion by Frieden, 'Invested Interests', pp. 427–33.

[17] See articles by Llewellyn and de Lattre in Tsoukalis (ed.), *Political Economy*, and chapter 6 of Susan Strange, *International Monetary Relations* (Oxford, 1976).

[18] Eric Helleiner, 'When Finance was the Servant: International Capital Movements in the Bretton Woods Order', in Cerny (ed.), *Finance and World Politics*, p. 39.

[19] Michael C. Webb, 'Understanding Patterns of Macroeconomic Policy Co-ordination in the Post-War Period', in Stubbs and Underhill (eds.), *Changing Global Order*, p. 177.

and individual tax burdens, and to adopt liberal market-oriented policies with respect to economic adjustment over time.[20]

There are, therefore, important pressures at work in the international system which propel governments to 'marketize' their economic policies over time. In terms of the financial system, this has been manifested by a breakdown in the traditional barriers between segments of the financial services sector (securities, banking, and to a lesser extent insurance), the consequent emergence of greater levels of competition among different types of financial institutions, and more competition among national financial sectors across borders. State policies are aimed at ensuring that national financial markets and exchanges are attractive to investors and that national financial institutions remain competitive and free of encumbering regulatory restrictions.[21] Regulators may become as concerned with the share of international transactions taking place on local markets as with issues of safety and soundness. The result has been more market-based systems of prudential supervision.

In a more marketized environment, greater levels of autonomy are necessarily conferred upon market actors. In distributional terms the consequences of this are far from neutral. This case will be clearly illustrated through the example of securities markets, but some general remarks on distributional effects are possible here. Distributional consequences will occur among social groups, firms, and economic sectors within particular economies, and among states in the global system itself. In the first place, one can expect financial integration to result in intensified competition among individual financial institutions and among national financial sectors with their different structures and levels of competitiveness. This will result in considerable restructuring, which some may well argue is beneficial in an aggregate and long-term sense, but involves important short-term costs on the more vulnerable market players. For example, intensified competition led to restructuring among financial institutions on the London markets following the Big Bang, with many old and venerable firms disappearing.[22] American, Japanese, and European firms now dominate the London markets, not British-owned concerns. Evidence from interviews suggests that the largest and best capitalized financial institutions on the whole derive the most benefit, according to regulators and market players alike.[23] Major market actors will also seek out the most favourable regulatory and market environments in which to place their market operations and raise capital, the phenomenon known as 'regulatory arbitrage'. This has considerable implications for

[20] On regulatory arbitrage specifically applied to financial regulation, see Cerny, 'The Deregulation and Reregulation of Financial Markets in a More Open World', in Cerny (ed.), *Finance and World Politics*, pp. 69–78. On the general phenomenon resulting from open finance, see discussion by Helleiner in the same volume, pp. 37–40.

[21] Cerny, 'The Deregulation and Reregulation of Financial Markets in a More Open World', in *Finance and World Politics*—see section II.

[22] Susan Hart, 'National Policy and the Revolution', and Paul Stonham, 'Big Bang: Short- and Long-Term Effects in the UK', in *Big Bang un anno doppo: Esperienze estere e proposte per la riforma dei mercati mobiliari italiani*, Incontri di Rocca Salimbeni, Siena, 27/18 November 1987, pp. 7–23.

[23] This point is corroborated by interviews with Paul Guy, Secretary General of IOSCO, Montreal, 10 December 1991; National Association of Securities Dealers, Washington DC, 1 October 1992; International Trade and Finance Research Group of the US General Accounting Office, 22 September 1992.

levels of market activity and employment in national financial sectors.[24] Finally, capital mobility affects various sectors of the economy in different ways, as Frieden has argued.[25] Multinational corporations with relatively mobile assets benefit more than those without similar options; exchange rate fluctuations linked to short-term capital flows and the related interest rate fluctuations induce holders of financial assets to move to more remunerative jurisdictions; and changes in the availability and price of capital affect the competitiveness of domestically oriented firms in the productive sector.[26] It can be argued that financial deregulation and transnationalization put considerable pressures on the industrial manufacturing sector with capital flows reflecting less and less the structure of trade in merchandise and services.[27] The increased capital mobility which results from the liberalization of the financial services sector, and the consequent integration of financial markets, therefore has consequences for the pattern of gains and losses among actors in the market and society in general.

In short, the ability of states to make independent decisions concerning important elements of economic policy-making has been considerably constrained by increased capital mobility and transnational financial integration. There have also been important distributional consequences for particular sectors of economic activity, which will be explored in more detail with respect to securities markets below. Where the desire of states to adopt an independent economic strategy emerges from the internal democratic processes of states—such as the desire to maintain and enhance an elaborate welfare state with the corporate tax burdens, labour market restrictions, and high wage levels which that implies—the effects of capital mobility have a clear impact on the democratic legitimacy of governments.[28]

IOSCO and the changing context of international securities markets

Structural change in securities markets

The public perception of securities markets is that they are highly internationalized—the very essence of the 'twenty-four hour global market place'. One hears on daily news bulletins of trading activity following the time zones of the globe, moving from New York to London to Tokyo incessantly. The reality is rather more subtle.

The past thirty years have certainly witnessed remarkable changes in securities markets. During the 1970s and 1980s, new bond issues called Eurobonds (bonds

[24] In London, for example, some 12 per cent of GDP was at stake in the early 1980s as the City contemplated reforms to the markets; see Hart, 'National Policy and Revolution', p. 223, p. 252.

[25] Frieden, 'Invested Interests', pp. 433–42.

[26] Frieden, 'Invested Interests', pp. 439–42.

[27] For a complete study of the effects of capital mobility, see Roy E. Allen, *Financial Crises and Recession in the Global Economy* (Aldershot, forthcoming).

[28] See Andrew Martin, 'Labour, the Keynesian Welfare State, and the Changing International Political Economy', in Stubbs and Underhill (eds.), *Changing Global Order*; also Jonathon Moses, 'Abdication from National Policy Autonomy: What's Left to Leave?', *Politics and Society*, vol. 22, 2 (June 1994), pp. 125–48. The French case referred to in note 4 is called to mind.

issued in a currency other than the domestic currency of the borrower, usually in several foreign centres) became major competitors to domestic and conventional foreign bonds in many financial centres. The same period saw the development of international markets in short-term securities or Euro-notes. These markets developed first in the United States and Britain where sizeable domestic markets in short-term notes like commercial paper had emerged in the 1970s. Over the course of the 1980s, other countries became involved, with France, for example, showing significant increases following the liberalization of its financial markets in the mid-1980s.

Cross-border trades in equities (a firm's shares are traded on the firm's local stock exchange by foreigners) have also grown importantly over the past two decades. In 1990, 11.8 per cent of all equity trading was in cross-border equities.[29] In addition, cross-exchange issuance, listing and trading occurs (a firm's shares are issued and/or purchased on foreign exchanges) in many locations, with the most important being SEAQ International in London. Cross-exchange trading has grown by a factor of 8 since 1986. When cross-exchange trading is combined with cross-border equity markets, they account for some 17.7 per cent of all trading in 1990.[30] These changes are parallel to similar processes in the banking industry.[31] In banking, across six major countries an average of 24 per cent of total banking assets and 27 per cent of all liabilities were foreign, 1989–1990.[32]

Finally, these two types of securities trading and products, whether traded in an international market or in a domestic market open to international influences, have brought their own special sets of risks leading to yet further innovations. Partly in order to hedge and protect themselves against some of these risks, financial services firms have increased their use of various new financial instruments, including interest rate and foreign exchange swaps, futures, and options. The success of these latter 'derivative' securities has led to the founding of new exchanges in London, Paris and Frankfurt and to the expansion of US commodities exchanges.

Despite the dramatic growth of transnational securities issuance and dealing, it is clear that the majority of trades remains the preserve of essentially national securities markets, particularly stock exchanges, and fits into national regulatory contexts. About 15 per cent of trades is genuinely transnational, a few major securities houses and international banks dominate the international side of the business, and only around 100 major companies are cross-listed on the three to five major stock exchanges in the world.[33] There is therefore some way to go before securities issuance and trading become fully internationalized in the sense of a common set of international listings operating under harmonized or at least approximate rules (see below). Important structural changes in the markets none the

[29] Michael Howell and Angela Cozzini, *Games Without Frontiers: Global Equity Markets in the 1990s* (New York, 1991), p. 25.

[30] Howell and Cozzini, *Games Without Frontiers*, pp. 24–5.

[31] For a good summary of trends towards transnationalization in banking and securities, see Toyoo Gyohten, 'Global Financial Market: the Past, the Future, and Public Policy Questions', in Franklin R. Edwards and Hugh T. Patrick (eds.), *Regulating International Financial Markets: Issues and Policies* (Dordrecht, 1992), pp. 13–20; and William D. Coleman and Tony Porter, 'Regulating International Banking and Securities', in Stubbs and Underhill (eds.), *Changing Global Order*, pp. 191–4.

[32] Coleman and Porter, 'Regulating International Banking', p. 192.

[33] Estimate based on research by the US General Accounting Office, interview 22 September 1992.

less continue to gather pace. The large, internationally active securities traders do account for a considerable proportion of trading in both domestic and transnational markets. Major institutional investors do move vast sums of savers' funds across the regulatory boundaries of the markets. These factors mean that domestic markets are increasingly being integrated into the international domain. Domestic authorities and regulators are responding to the trend towards transnationalization via domestic reform programmes yielding substantial liberalization of established arrangements.[34] This means that domestic reform and transnationalization are in fact interrelated processes.

The economic rationale for the marketization and transnationalization of the securities business is fairly clear: the development of open transnational markets will allegedly lead to more efficient capital markets and thus economic growth. Yet this notion of the consequences of liberalization needs more critical examination in the light of the arguments outlined in the introduction to this article. If the popular perception of securities markets as the very essence of the twenty-four hour global market place is somewhat inaccurate, and if the sorts of changes dealt with below and which are under discussion at IOSCO and in other forums (such as the Uruguay Round liberalization of trade in financial services,[35] the Basle Committee initiatives, and so on)[36] will have an impact on the societies and political economic choices in which we live, the political economy of liberalization should be better understood. The next section analyses in detail the case of IOSCO, its aims and policy process, and raises further questions with respect to political legitimacy.

The International Organisation of Securities Commissions: an Introduction

IOSCO was founded in 1984 as an offshoot of the Inter-American Association of Securities Commissions and emerged in 1986 into the new market environment facing pressures to resolve international regulatory problems.[37] No one national regulator could cope with the rapidly growing transnational markets with respect to prudential supervision, and there was pressure from the industry and others to facilitate the transnationalization process through attempts at regulatory harmonization and convergence.[38]

[34] See Michael Moran, 'Regulatory Change in German Financial Markets', in Kenneth Dyson (ed.), *The Politics of German Regulation* (Aldershot, 1992), pp. 137–57; *Financial Times, Financial Regulation Report*, paper on Finanzplatz Deutschland, February 1992.

[35] See Underhill, 'Negotiating Financial Openness', especially the section entitled 'The Argument'.

[36] For a good and constantly updated summary of changes in the regulatory framework of financial markets, see *Financial Times, Financial Regulation Report (FRR)*, monthly. For example, the July 1992 issue examines changes in the EU such as the agreement on the Capital Adequacy Directive and in-principle agreement on the Commission's Investment Services Directive, as well as changes in the US (Futures Reform Bill/banking reform), or the UK (the Bank of England and BCCI's collapse, proposed new governance structure at Lloyd's insurance market). Another useful source is *International Securities Regulation Report*, Buraf Publications, Washington.

[37] Paul Guy (Secretary-General of IOSCO), 'Regulatory Harmonization to Achieve Effective International Competition', in Edwards and Patrick (eds.), *Regulating International Financial Markets*, p. 291.

[38] For an analysis of the convergence process, see Michael Moran, *The Politics of the Financial Services Revolution* (London, 1991), especially the arguments in the last chapter on pressures from the private sector for convergence, pp. 130–5.

IOSCO's members[39] are official national securities regulators responsible for their respective markets. Most often this definition means an autonomous government agency mandated by legislation to take on the responsibility of supervision and regulation, the archetypal examples being the French *Commission des Opérations de Bourse* (COB) and the American Securities and Exchange Commission (SEC). Sometimes, however, the member is a division of a national finance ministry, a designated self-regulatory organization (e.g. stock exchange), or even a central bank, depending on the regulatory traditions of the member country. In addition there are 'associate' and 'affiliate' members. Associate membership caters to countries with more than one securities regulator, as in federal jurisdictions, but each country is only allowed one vote.[40] Affiliate members are self-regulatory organizations (SROs) or trade associations with self-regulatory responsibilities.[41] They do not vote but their involvement is considered crucial to the success of the organization. The close relationship between official regulators and SROs should be noted. Most official regulators, while they retain their full legal powers of supervision and examination of financial firms, operate by delegating their powers to SROs. The SEC delegates to the National Association of Securities Dealers and the respective stock exchanges (i.e. New York Stock Exchange). In the British case, the Securities and Investments Board delegates to six self-regulators representing various segments of the financial services sector. As a result IOSCO, as a club of regulators forming a sort of policy community with extremely close ties to the industry they purport to supervise, considers itself a non-governmental international organization.[42] Membership at the end of 1992 was 102[43] including associate and affiliate members.

IOSCO's structure is relatively straightforward. The governing body of the organization is the President's Committee, which meets once a year to establish guidelines for the operation of the more important Executive Committee. In addition, there are regional standing committees. The membership is then split into members of the Development Committee (members representing countries with so-called 'emerging markets', including those in the former East Bloc) and the Technical Committee on International Transactions, which consists only of members from 'the most developed markets'.[44] There is no doubt that the Technical Committee is the most important body in the organization when it comes to international regulatory and supervisory cooperation. Finally, the Consultative Committee provides a forum for consulting among IOSCO permanent members and affiliates.

The objectives of the organization largely concern cooperation among members to promote and establish regulatory standards to facilitate international securities transactions, including mutual assistance, surveillance, and enforcement of standards so as to ensure the integrity of the markets. The overall aim is to provide on a global scale 'the benefits derived at the domestic level': 1) to cooperate to improve

[39] See *By-Laws of the International Organisation of Securities Commissions*, Washington, DC, September 1991, for details of IOSCO membership and other rules.
[40] An exception was made for Canada for historical reasons, and both the Ontario and Quebec Securities Commissions have a vote.
[41] Interview with Paul Guy.
[42] Interview with Paul Guy.
[43] IOSCO, *Annual Report*, 1992.
[44] Paul Guy, 'Regulatory Harmonization to Achieve', p. 293.

international regulation so as to ensure just and efficient market operations across borders; 2) mutual information exchange among members to enhance the quality of domestic markets; 3) cooperation to establish 'standards and an effective surveillance of international securities transactions'; and 4) 'to provide mutual assistance to ensure the integrity of the markets by a rigorous application of the standards and by effective enforcement against violations.'[45] The organization's main thrust is therefore the removal of regulatory barriers and barriers to enforcement of national standards, which necessarily involves a degree of harmonization across regulatory boundaries. The Technical Committee, currently chaired by the President of the French *Commission des Opérations de Bourse*, has established four working groups. Each addresses an issue of importance to the objectives of the organization, with particular emphasis on examining 'impediments to international transactions and [proposing] ways of eliminating these impediments'.[46] The working groups are: (1) Multinational Disclosure and Accounting Standards; (2) Regulation of Secondary Markets; (3) Regulation of Market Intermediaries; (4) Enforcement and the Exchange of Information; a fifth working party on Investment Management is soon to be established.[47] In addition, the organization has worked on facilitating international equity offers through the harmonization of information requirements and prospectuses.

The IOSCO process

Although other bodies deal with these matters, such as the International Accounting Standards Committee and the Group of Thirty,[48] and bilateral deals continue to play an important role as catalyst in multilateral discussions,[49] IOSCO has emerged in the 1990s as the principal body dealing with international regulatory problems. Its role has been recognized by the central bankers and IOSCO now works in close consultation with the Basle Committee on Banking Supervision on prudential issues of common concern in view of the increasing involvement of banks in securities trading.[50] This growing centrality of IOSCO is not without difficulty: while central bank cooperation goes back to the nineteenth century, multilateral cooperation

[45] IOSCO, *By-Laws*, September 1991.

[46] Paul Guy, 'Regulatory Harmonization', p. 294.

[47] IOSCO, *Annual Report*, 1992, p. 8, p. 18. There have been some rationalization and changes among working parties since 1989–1990.

[48] Interviews with Paul Guy, other regulators. The Group of Thirty is a consultative organization consisting largely of business leaders and some notable policy-makers from the major western market economies. The group's work with respect to securities markets has largely been on clearing and settlement issues; see Group of Thirty, *Clearance and Settlement Systems in the World's Securities Markets* (London and New York, 1989).

[49] See, for example, the joint statement of the SEC, the Commodity Futures Trading Commission, and the British Securities and Investments Board concerning joint oversight of the derivatives markets: *OTC Derivatives Oversight*, Washington, DC, 15 March 1994.

[50] See chapter 4, pp. 111–47 of Tony Porter, *States, Markets and Regimes in Global Finance* (London, 1993), especially pp. 111–12. As the article proceeds with the analysis of IOSCO's efforts with respect to capital adequacy and international equity offers, the central role of IOSCO will become increasingly clear. The entry of IOSCO into negotiations with the Basle Committee was a crucial step in this regard.

among securities regulators is relatively recent, dating from the mid to late 1980s and the founding of the organization. As the case material below will point out, achieving agreement in IOSCO is often an extremely arduous and conflictual process, and this limits the organization's effectiveness. This reflects the fact that transnational securities markets are a relatively recent phenomenon in themselves. None the less, it seems clear that the negotiations are gathering pace, but that there are many issues relating to transnational securities trading and issuance which have yet to be tackled in a serious manner, emphasizing the point already established above, that there is a long way to go before genuine international markets emerge.[51]

By examining the IOSCO process, we can come to understand the pressures behind the transnationalization of securities markets and come to terms with IOSCO as a political process. The work of IOSCO is characterized by low-profile negotiations to harmonize securities regulation and supervision in order to facilitate the emergence of transnational securities issuance and trading. It also seeks to regulate the international securities operations which result. It is in this way an example of the political process of conflict and cooperation which surrounds the creation of markets across borders. In line with the central arguments of the article, the success of this process has considerable consequences for the structure and characteristics of securities markets and for the market actors involved: there will be winners and losers.

The principal benefits are expected to flow to the largest firms with an established transnational presence.[52] Furthermore, there are patterns of gains and losses for national and local exchanges themselves. As the largest exchanges (Tokyo, London, and New York) become increasingly integrated and constitute the core of the emerging global securities market, regulators and in some cases governments in other markets are compelled to undertake reform programmes which lead to the restructuring of domestic markets with commensurate costs for local exchanges and market intermediaries. Smaller exchanges seek to protect their listings and attract listings of foreign stocks in competition with the better placed larger exchanges: 'each seeks to be a vital part of an effective concentration of financial services in its own capital'.[53] At the very least, they attempt to retain trading in their own domestic stocks and in some cases delay the reform process to grant a breathing space to the brokerage community and the exchange authorities.[54] In the case of Germany, for example, reform proposals were resisted successfully for some time. Eventually the essentially Frankfurt-based, large-firm interests in favour of integration into the global markets won the day and reform proposals were issued which would create a single exchange for all of Germany, replacing the currently separate exchanges in Munich, Berlin, and Frankfurt.[55] These German market reform proposals came to be known as the *Konzept Finanzplatz Deutschland*, outlined in a paper by Economics

[51] This perception is clearly emphasized in interviews with IOSCO officials and national securities regulators.

[52] Extensive interview evidence corroborates this claim.

[53] See Jeffrey Knight, Sonia Mazey, and Jeremy Richardson, 'Groups and the Process of European Integration: the Work of the Federation of Stock Exchanges of the European Community', in Sonia Mazey and Jeremy Richardson (eds.), *Lobbying in the European Community* (Oxford, 1993), p. 167.

[54] Knight et al., 'Groups and Process', pp. 166–7; p. 169.

[55] See Moran, 'Regulatory Change in German Financial Markets', pp. 137–57.

Minister Waigel in January 1992.[56] In the context of the European Union's single market for financial services, Spain and Portugal have attempted to negotiate delays in the implementation of some Commission directives, temporarily reserving stock exchange seats for specialized domestic intermediaries.[57] They can do little but stave off the inevitable. Even London (as has already been noted), with its historic role at the centre of international capital markets, is no longer a British financial community but is heavily dominated by Swiss, Germans, and especially Japanese and American firms.

If the consequences of IOSCO's work are significant for securities markets, in line with the article's broader arguments with respect to capital mobility, then it is worthwhile taking a brief look at examples of IOSCO negotiations which seek to facilitate the process of transnationalization. Reference will only be made to two of IOSCO's more important issues under consideration: the negotiations relating to International Equity Offers,[58] and those relating to Capital Standards for international securities firms.[59] The emphasis of the negotiations on international equity offerings is essentially on facilitating the development of transnational securities issuance and, eventually, trading. The capital adequacy case likewise seeks to do this but also reflects an important concern with investor protection. Other examples of current negotiations include information exchange for investor protection, insider trading rules, accounting standards for international markets, the development and harmonization of electronic trading systems, clearing and settlement arrangements, and so on.[60]

Case 1: *international equity offers and securities dealing*

Although a number of large securities firms such as Goldman Sachs or Nomura operate internationally, trading American securities in Japan or European equities on Wall Street, they are none the less operating in distinct markets. A company stock which is traded internationally still requires separate listings on the relevant exchanges and observation of the regulatory requirements of each. New issues require even greater levels of compliance with specific market rules: prospectuses

[56] See *FRR*, February 1992.

[57] See Article 15 of the Investment Services Directive: 'Council Directive no. 93/22/EEC of 10 May 1993 on Investment Services in the Securities Field', in *Official Journal of the European Communities* (Legislation), L141, vol. 36, 11 June 1993.

[58] See IOSCO, Working Party on International Equity Offers, *International Equity Offers*, September 1989. There are also various updates to be found in IOSCO annual conference proceedings, and a periodic document entitled *International Equity Offers: Changes in Regulations since . . .*, since June 1989, since April 1990, etc.

[59] See IOSCO, *Capital Adequacy Standards for Securities Firms*, Report of the Technical Committee of the International Organisation of Securities Commissions, October 1989, and *Financial Times, Financial Regulation Report*, February 1992. Updated information is available in the IOSCO annual conference proceedings, particularly the report of the Technical Committee.

[60] For a survey of the issues under consideration and an account of progress, see IOSCO, *Annual Report*, various years, and IOSCO, *Documents of the XVI Annual Conference*, Washington, DC, 23–26 September 1991, 2 vols., and earlier annual conference proceedings.

and disclosure requirements are, for example, different.[61] In sum, there is no transnational *market* as such—just simultaneous quotation and trading in the shares of, typically, multinational corporate entities on the principal exchanges of the global market. In addition, clearing and settlement arrangements vary in terms of the length of time firms may have to wait to receive payment, there are different standards relating to fraud and market transparency, and a substantial exchange rate risk over time in the transnational trading process.

The costs of operating in multiple regulatory systems in a highly competitive business with notoriously small margins are considerable. Hence, only major players can afford to do so.[62] Much of IOSCO's energy is thus devoted to harmonizing the regulatory requirements of the principal markets for securities in the global economy, which would cut costs and integrate markets more rapidly. IOSCO hopes that if international rules can be agreed for that small segment of the market which becomes properly transnationalized, then there will be further pressure on domestic regulators for a more thoroughgoing harmonization across borders.[63]

IOSCO's work in this domain takes place through a working party established in 1987 'to make a study of the emerging methods of offering equity securities on a multinational basis . . . to promote regulations which facilitates the process whereby world class issuers can raise capital in the most cost effective and efficient way in all capital markets where investor demand exists'.[64] The first step was to gather information on the various national practices and policy issues involved in international equity offers. The various legal structures and national policy goals of markets in different jurisdictions 'undermine the efficiency of the capital raising process in a global market'.[65] IOSCO was particularly concerned with public offerings of securities, as opposed to 'private' offerings to institutional investors, sometimes referred to as 'Euro-offers'.

IOSCO's report goes on to outline the principal obstacles to international equity offers. In the first place, there were different practices as far as processing the initial offers prior to sale was concerned. Some jurisdictions took longer than others, and some had more rigorous requirements. This tied into 'disclosure practices' such as the requirements for audits and financial statements, all of which go into the approval of the prospectus for a public offer. Costly legal and other professional advice on these matters was necessary in each separate jurisdiction. The aim is to move towards a single common prospectus for the major securities exchanges where multinational offerings are typically made.[66] Existing differences on prospectuses were mirrored in the domain of 'continuing obligations': ongoing

[61] Interview with Paul Guy; there is also considerable evidence in the IOSCO documentation gathered under this research project.
[62] Interview with Paul Guy.
[63] Interview with Paul Guy. For a thorough discussion of the issues surrounding international equity offers, see IOSCO, Working Party in International Equity Offers, *International Equity Offers*, September 1989, and further updates on the issue in IOSCO annual reports and annual conference proceedings.
[64] *International Equity Offers*, September 1989, p. 7.
[65] *International Equity Offers*, September 1989, p. 8. The following account of the international equity offers problem comes from pp. 7–13 of this report unless otherwise indicated.
[66] It should be noted that the European Union, through its Admission Directive, has moved towards the mutual recognition of listing particulars and there is other legislation covering issuance prospectuses; *International Equity Offers*, September 1989, p. 20.

disclosure requirements, reports, and financial statements which dealers and issuers must submit to the respective national authorities.

Two more issues were particularly important. First, the UK had substantially different underwriting practices from most other major exchanges. This was for historical reasons, but given the important place of the UK's International Stock Exchange as far as international securities are concerned, this was no small difficulty. It had repercussions for both Europe and the broader international financial services sector. Secondly, and most importantly, differences in clearance and settlements systems in the various markets were a substantial obstacle. There were no linkages between national clearing networks, and settlement and clearing arrangements are generally set by the issuer's country of origin.[67] There are few principles common to all clearing arrangements, and this is a major barrier of uncertainty and cost to multi-jurisdictional offers. Likewise the settlement dates and procedures differ from country to country for secondary trading. Sometimes there are different rules for domestic as opposed to foreign trades, making for a level playing-field problem.[68] Overall, 'the Working Party consider[ed] that . . . growth in the number of issuers able to make international equity offers will be severely inhibited' in the absence of effective and harmonious international clearing arrangements on the lines of the *Euroclear* and *Cedel* systems for Eurobonds.[69]

The report's recommendations encouraged harmonization or a system of reciprocity/mutual recognition on these matters.[70] However, it was recognized that any changes would have to be consistent with the legal mandates of the member organizations. In addition, a major information gathering exercise was begun in the form of an annual report detailing the changes in regulations on international equity offerings made in members' jurisdictions.[71] If these IOSCO efforts bear fruit, the integration of distinct securities markets and the growth of transnationalization will be considerably enhanced.

Case 2: *capital adequacy*

The problem of capital adequacy is a complex one and is dealt with by IOSCO's working party 3 on market intermediaries. Capital adequacy for securities firms is in principle similar to the notion of capital reserves in international banking—it serves to ensure that financial intermediaries remain solvent, protecting investors and

[67] *International Equity Offers*, September 1989, p. 59.
[68] *International Equity Offers*, September 1989, p. 60.
[69] *International Equity Offers*, September 1989, pp. 60–61. The report went on to welcome, and defer to, the work of the Group of Thirty and the *Fédération Internationale des Bourses de Valeur* (International Federation of Stock Exchanges) for their work in this regard.
[70] See *International Equity Offers*, 1989, pp. 75–6.
[71] See for example, IOSCO, *International Equity Offers: Changes in Regulation since April 1991*, September 1992.

avoiding the systemic risk of a general crash.[72] However, there are important differences between the concept for banks and securities houses. Banks have a balance sheet which can be rendered relatively transparent; then there is the problem of 'off-balance sheet' items such as underwriting commercial paper and so on. Assessing the risk associated with the latter is difficult. International securities firms' portfolios are *all* off-balance sheet as such. There is no question of assessing the risk of an established loan portfolio: while securities firms do borrow from banks and others, which carries with it the problem of indebtedness and 'counterparty risk', for the most part risk in the securities sector is related to the firm's *position* in the market: position or market risk.

Securities firms hold portfolios of shares and bonds, and even commodities/equities futures, which they purchase in anticipation of client demand as well as on behalf of clients. They also underwrite new issues of securities. The value of these securities can be volatile in contemporary market conditions, and the position changes rapidly in response to developments in the market. Assessing the risk position of a securities house is therefore a complex task: transparency is not easy to establish. This is because firms might store up securities at outdated (inflated) values in difficult market conditions and thus undermine their own financial position: solvency is difficult to determine in rapidly changing market conditions. They also might end up holding debt securities (bonds) in their trading portfolio wherein the principal and interest are not being paid by issuer or underwriter.[73]

It is for this reason that the Technical Committee of IOSCO insisted from the outset that international capital adequacy standards would be based on 'marking marketable securities and commodities positions to market' so as 'to give a true picture of a firm's position'.[74] In addition to problems of position risk, in international trading there are substantial exchange rate risks involved for securities houses, and the settlement/clearing process can pose liquidity problems even for the largest firms. Of course, extensive (and expensive) reporting and examination requirements are necessary.

Furthermore, different regulators have different systems of measuring capital, meaning that the requirements in one market are different from those in another, increasing the uncertainty and the difficulty of monitoring international transactions. The American SEC insists on measurement of capital in relation to position risk on a gross basis. This means that firms operating in US markets are not allowed to 'net' their long and short (buy/sell) positions. This principle means that a firm must hold a minimum of 15 per cent (more in some circumstances) of its market

[72] Central bankers may point out that the banking system is inherently more sensitive, as far as prudential supervision is concerned, than the securities sector because consumer deposits of a wide range of social groups are tied into retail banking. The collapse of the banking system would have catastrophic consequences for the entire economy. As one central banker said to this author, 'If a securities house collapses, who cares?' This distinction is less and less significant, however: on the one hand, banking and securities are more and more intertwined due to regulatory changes and market innovation (disintermediation and securitisation); on the other, the savings of consumers are increasingly managed by institutional investors through pension funds and insurance companies, and these firms are heavily involved in securities markets. A severe market collapse would destroy the savings of a substantial portion of the working population.

[73] These issues are discussed clearly in IOSCO, *Capital Adequacy Standards for Securities Firms*, Report of the Technical Committee, 1989, pp. 11–17.

[74] *Capital Adequacy Standards*, p. 5.

position as capital to offset risk.[75] Furthermore, the US measures capital based on the 'comprehensive' approach. Capital must cover a combination of specific risk (risk of a fall in the price of a specific security) and general market risk (risk of a general fall in the market). The comprehensive approach stipulates so-called capital 'haircuts' which pare required levels of provision down to a minimum acceptable component of the total risk to which a firm is exposed as a result of its market position at any one time (in the US case, a haircut of 15 per cent). Total risk is essentially the net worth of the firm's market position.

Contrast this approach to the 'building block approach' originally proposed by Germany (and eventually adopted) in the EU negotiations. This approach allows different levels of provision for specific and general risk, and the components are added together. This approach also permits netting: there is a percentage provision required for gross market positions of an equity, and a separate percentage required for net provisions (long vs. short). In this way a regulator might require 8 per cent capital on gross positions and 15 per cent on net positions. These contrasting measurements of capital adequacy are politically charged because they relate to the costs of operating in the respective markets and, according to the proponents of the US position in particular, to varying levels of investor protection.

There is an additional constraint on the IOSCO agreement under negotiation. The de-segmentation of the financial services industry in a number of important markets (especially the US and the City of London, but increasingly Japan as well) has led to an intermingling of securities houses with international banks. This has meant that the IOSCO capital adequacy standards had to be compatible with those established for international banks in the context of the Basle Committee on Banking Regulation and Supervisory Practices based at the Bank for International Settlements (BIS). IOSCO has managed to establish very good relations with the BIS process of central bank cooperation on capital adequacy.[76] Furthermore, the IOSCO process, like that of the Basle Committee, had to fit with developments in the European Union's (1992) Single Market project. This meant compatibility with the EU Commission's Investment Services and Capital Adequacy Directives.[77] All in all, the multilateral harmonization or even convergence of capital adequacy standards is a complex issue to resolve requiring extensive measures of cooperation among not just IOSCO members, but also other international bodies. However, the agreement of capital adequacy standards among IOSCO members is a necessary component of the emergence of transnational securities markets. It is also an important element in strategies to deal with the public policy consequences of the emergence of these markets: the risk of general financial instability or collapse.

The road to an IOSCO agreement on capital adequacy has been a difficult one, and despite signs of optimism in mid-1992, the prospect is now somewhat gloomy.

[75] US General Accounting Office, *Challenges to Harmonising Capital Standards Remain*, p. 28; p. 34; Confidential interviews, Washington, DC, September 1992.

[76] Interview with Paul Guy.

[77] European Communities, 'Council Directive no. 93/6/EEC of 15 March 1993 on the capital adequacy of investment firms and credit institutions', and 'Council Directive no. 93/22/EEC of 10 May 1993 on Investment Services in the Securities Field', both in *Official Journal of the European Communities* (Legislation), L141, vol. 36, 11 June 1993. The IOSCO/Basle Committee preliminary agreement on capital adequacy for securities firms was close to the proposed EU Capital Adequacy Directive (*Financial Times, Financial Regulation Report*, February 1992, p. 10).

This is perhaps not surprising. Capital adequacy is an issue which sets different national regulatory traditions and cultures at loggerheads, particularly the US and the recently established EU models. A great deal is also at stake: a lower capital adequacy standard enhances the attractiveness of a particular market to dealer firms and their investor and issuing clients because it lowers costs. As was the case with the banking industry, capital standards involve questions of a level playing field and regulatory arbitrage among national equities markets.[78]

It took three years to come up with any preliminary results, despite the fact that IOSCO had agreed on a set of common principles published in October 1989.[79] The first IOSCO/Basle Committee preliminary agreement came at the end of January 1992.[80] The two groups expected a joint consultative paper by the summer of 1992. There were clouds on the horizon, however, as a small minority of IOSCO members, led by the UK, were holding out 'for a 2% requirement for gross equity risk' as opposed to the 4 per cent proposed.[81] None the less, a preliminary understanding had been reached. The IOSCO accord was understood to be a minimum standard and the parties could insist on higher standards for their markets if they so desired. The agreement also accepted the building block approach, which was unexpected in view of the US position. It was in essence a '4 + 8' agreement: a minimum of 4 per cent provision would be required against a firm's gross position in an equity to cover specific risk, and a minimum of 8 per cent of the net position as provision against general market risk, and there was support for this accord in the Basle committee.[82] However, the US had insisted that the minimum level of the two 'building blocks', once netting was allowed for, would have to be 10 per cent overall.[83] It appeared that securities and banking supervisors were on the brink of a historic global agreement.

The IOSCO/Basle negotiations ran in parallel to the EU negotiations on the equivalent regulation for the 1992 Single Market Initiative, referred to as the Capital Adequacy Directive (CAD). The EU text was leaving open the possibility of amendments pending a global agreement on the issue.[84] Eventually the EU talks outpaced those in IOSCO, with agreement on the Capital Adequacy Directive being reached in July 1992.[85] The EU adopted a common position close to that of the UK. On the face of it the CAD was broadly similar to the IOSCO/Basle accord, '4 + 8'. However, an additional provision was inserted under the British presidency of the EU Council in the final round of negotiations: under certain circumstances a '2 + 8' provision would apply. A firm with a highly diversified and liquid portfolio could reduce the 4 per cent provision on gross positions for general risk to 2 per cent.[86] This provision would apply only to certain sophisticated market players with the capacity perfectly to net long and short positions (a 'hedging strategy') across the

78 For an account of the Basle agreement on capital adequacy for international banks, see Ethan B. Kapstein, 'Resolving the Regulator's Dilemma: International Co-ordination of Banking Regulations', *International Organization*, vol. 43, 2 (1989), pp. 323–47.
79 IOSCO, *Capital Adequacy Standards* . . .
80 *FRR*, February 1992, pp. 8–10.
81 *FRR*, February 1992, p. 9.
82 *FRR*, February 1992, pp. 11–12.
83 Confidential interview, Washington, March 1994.
84 *FRR*, June 1992, p. 2.
85 *FRR*, July 1992, p. 2.
86 *FRR*, November 1992, pp. 8–9.

diversified portfolio.[87] The approach is in line with current 'portfolio theories' of securities regulation.[88]

This clause in the CAD, which was eventually agreed, proved anathema to the Securities and Exchange Commission. Not surprisingly in these circumstances, the issue blew up to IOSCO's annual conference (25–29 October 1992) in London when the UK put forward a proposal reflecting the EU's Directive.[89] This proved to be unacceptable to the Securities and Exchange Commission. Its chairman, Richard Breeden, was undiplomatic to say the least in his defence of the SEC approach.[90] The SEC appeared particularly determined to avoid any hint of regulatory arbitrage, driving effective capital adequacy to what it considered to be inadequate levels.[91] The SEC continued to hold out for a 4 per cent minimum requirement on gross.[92] The Americans argued that if portfolios are perfectly matched or netted, then the 8 per cent net requirement is effectively void, leaving only 2 per cent against the gross position.[93] Furthermore, it has been argued that the US market is different from the European market, especially London. The London market is a wholesale market; most of the operators are subsidiaries or branches and they have a sound and more tightly regulated parent in the background, often in the US or Japan. In a wholesale market large institutions with sound market and risk information place orders with broker-dealers and have little need of protection. In contrast, the US market is a market with a substantial presence of small investors, and so customer protection is a primary objective.[94]

The failure to reach agreement appeared to prompt Breeden to downgrade the importance of IOSCO on this issue.[95] However, the US is under considerable pressure to change its more rigorous standards so that the business of US securities exchanges is not undercut by rivals overseas, and to cement a global IOSCO/Basle deal. When the Basle proposals on standards for banks' international securities activities were released for consultation with the industry on 30 April 1993,[96] they broadly shadowed the CAD minus the '2 + 8' clause. They also contained an explicit commitment to pursue further discussions with a view to convergence with the CAD so as to avoid undue competitive inequalities between banks and investment dealers. The EU/Basle accord appears very much like an emerging multilateral standard.

[87] *International Securities Regulation Report*, vol. 5, 23 (November 3, 1992).
[88] See paper by Elroy Dimson and Paul Marsh, 'The Debate on International Capital Requirements: Evidence on Equity Positions Risk for UK Securities Firms', City Research Project, London Business School, February 1994. The portfolio approach argues that the SEC approach to capital adequacy is inefficient and outmoded.
[89] *FRR*, November 1992, p. 8.
[90] *International Securities Regulation Report*, vol. 5, 23 (November 3, 1992), pp. 8–9.
[91] *FRR*, November 1992, p. 9.
[92] *Financial Times*, 27 October 1992, p. 33.
[93] *FRR*, November 1992, p. 9.
[94] Interview sources, Washington, September 1992. The concern with investor protection is corroborated by the GAO report, pp. 51–2. However, it is not clear that the small investor is as important to the US markets as claimed; major investors often deal off-exchange, sidestepping regulations (interview sources; US General Accounting Office, *Securities Markets: Challenges to Harmonising Capital Standards Remain*, Report to Congressional Committees, GAO/GGD/-92-41, March 1992, pp. 28–9), but investor protection is certainly a major concern of Congress.
[95] *International Securities Regulation Report*, November 3, 1992, p. 8.
[96] *FRR*, May 1993, pp. 2–7.

The SEC draws attention to 'the market for safety, soundness, and integrity'.[97] The agency believes that firms will seek to operate in the US market with its high standards over the long run, despite the pressures on firms to reduce costs. Officials point out that large firms have seldom even come close to the minimum US standards in active trading. Only large and well-capitalized firms can play a serious game, and tend to have excess capital in the hundreds of percentage points. None the less, the dynamics of regulatory arbitrage may yet take over if the US markets begin to lose trade to the new Europe with its lower standards. This means that the United States is under considerable pressure to adjust its standards downwards towards the EU/Basle agreement. Already the SEC is considering a portfolio approach towards derivatives regulation[98] and may have to do so in a wider context. If the United States cannot stand up for the principles and standards it seeks for its markets in an era of increasing globalization, few others can.

The IOSCO process and political legitimacy

It has been argued that the transnationalization of securities markets is problematic, in terms of political legitimacy, from a number of points of view. The pressure on the SEC to adapt to the emerging global standard reinforces this view. By looking at IOSCO's work it has been possible to understand the sorts of changes which are likely to occur and consider the issue of gains and losses among the actors involved. There are also some broader consequences for state policy. These derive from the policy linkages of securities regulation with other issues on the state policy agenda. The emergence of transnational securities markets may accelerate the circulation of capital from one jurisdiction to another, constraining governments through market pressures. The markets will require an ongoing commitment by governments to the liberalization of capital flows. Next, national authorities will no doubt find it more difficult to affect the process of capital formation to aid the process of economic development and adjustment, should their domestic traditions and policy choices point them in that direction, when the market for capital is heavily transnational. Finally, the more market-oriented financial system which will emerge may well be more volatile. This has been the case with the emergence of international banking through the Euromarkets. The risk of financial collapse in the absence of a clear political community to manage the transnational markets is of considerable public interest concern. In sum, the steady emergence of transnational securities markets in the international system of states poses challenges for state policies and for the societies to which states are theoretically accountable alike.

The case of securities markets is first and foremost, however, a specific sectoral example of the transformations which financial integration and capital mobility bring to the global economy and their distributional effects. It has also been stated that the IOSCO policy process, *in and of itself*, exacerbates the general problems posed by capital mobility. This part of the argument needs greater attention at this

[97] Confidential interviews, Washington, DC, September 1992.
[98] SEC/SIB agreement, *OTC Derivatives Oversight.*

stage. In order to do this it is necessary to reflect upon the relationship between the process of marketization (developing and extending the domain of markets in the economic decision-making process) in the transnational domain, on the one hand, and the institutions of the national political communities (states) through which the politics of the international system characteristically occur, on the other.

To start with, there is the nature of the IOSCO policy community. It has been established that IOSCO and its membership considers itself a *non*-governmental organization. It would do to remind oneself of some of the points made earlier. IOSCO's members are part of an industry with a long-standing self-regulatory tradition.[99] Stock exchanges have traditionally been run by their membership, the financial intermediaries, and have accepted the need for integrity as a means of attracting investors. Even statutorily 'independent' securities regulators have considerable autonomy from other state institutions, and they work in close communion with stock markets (typically self-governing institutions) and the market actors (firms) themselves. Even where an 'independent' or government agency regulates the market, it most often only oversees what the self-regulatory organizations do. This is the case with the French *Commission des Opérations de Bourse* and its SRO (*Conseil des Bourses de Valeurs*).[100] Even the interventionist US Securities and Exchange Commission in fact delegates regulation to the national SRO to which all securities dealers in the US must belong, the North American Securities Dealers Association (NASDA), which in turn oversees the work of the self-regulating stock exchanges themselves.[101] In Germany, regulation is carried out by the Federation of Stock Exchanges with limited Ministry of Finance oversight, and in the UK the statutory Securities and Investments Board supervises the work of six SROs.[102] Market-makers and securities exchanges are also the main domestic political 'constituencies' from which securities regulators draw their legitimacy. The views of their constituents are crucial to a consideration of the competitiveness both of domestic securities exchanges and of national firms operating in the transnational market- place.[103] Regulators develop their policies in commensurately close consultation with market intermediaries, even where international agreements are involved.[104] The fact is that market regulations cannot be made to stick when market actors can elude regulatory

[99] See Michael Moran, *The Politics of the Financial Services Revolution.*

[100] Bruno de Maulde, 'The Role of Practitioners and Self-Regulatory Organisations in the Regulation of Financial Services', paper presented to Annual Conference of IOSCO, London, 25–29 October 1992.

[101] Interview with officials of the NASDA, Washington, DC, 1 October 1992. In fact the more interventionist style of the SEC is relatively recent, dating from the early 1970s as the distinction between banks and securities houses involved in the Euromarkets began to break down (Interview evidence).

[102] David S. Ruder (former SEC chairman), 'The Role of Practitioners and Self-Regulatory Organisations in the Regulation of Financial Services', paper presented to the Annual Conference of IOSCO, London, 25–29 October 1992, pp. 4–5.

[103] This is very clear from IOSCO documentation, Annual Conference material, numerous interviews conducted in Washington, DC, with securities regulators, SROs, and firms (20 March–4 April and 20 September–4 October 1992), as well as an interview with Paul Guy, Secretary General of IOSCO.

[104] This has been true of attempts to regulate the derivatives business of banks and securities houses and the consideration of the 'portfolio approach' to regulation of international securities markets in Europe and the US (confidential interviews, March 1994).

jurisdictions by moving off-shore; the situation is not far from classic regulatory capture.[105]

This means that the IOSCO policy community consists in the main of autonomous government agencies, self-regulatory organizations (SROs) and market actors, interacting as non-governmental institutions in the international domain. In this case, the guardians of the rules of the market, and indeed those who make the very rules and create market structure, are somewhat removed from traditional legislative accountability. Adam Smith was particularly concerned with the role of vested interests in the control of the regulatory framework of the market:

> The interest of the dealers . . . in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market and narrow the competition, is always the interest of the dealers . . . The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with greatest precaution . . .'[106]

Many securities commissions can come to an agreement with their partners in IOSCO without the need to seek legislative changes in their own domestic political systems. This depends of course on the nature of the issue at hand, but applies to the definition of capital adequacy and to much of the change required for the regulatory harmonization of international equity offers. Certainly, undertakings at IOSCO are binding whether there are legislative changes required or not—the implementation process is the responsibility of the members.[107]

This is not to say that democratic accountability is entirely absent in the policy process. Securities regulators, particularly if they are statutorily independent, can be very autonomous of Smith's 'dealers' and even SROs, given their quasi-judicial roles. The American Securities and Exchange Commission is the archetype here.[108] SROs are fully aware that they must guard the integrity and liquidity of markets if these are to maintain their share of international business and capital—investors are hardly attracted by the prospect of others taking their money through fraud. Some securities regulators are, as mentioned, branches of the government ministry of finance (although usually operating at arm's length), and most have at least some form of governmental or legislative oversight. Yet, it seems clear that open public debate about the issues involved is limited in scope, even in the case of major statutory reforms of the financial structure, such as the legislation for London's 'Big Bang' or the French equivalent.[109] There is considerable debate *within* the policy community about the appropriate role for market practitioners and SROs in regulating the

[105] On the capture of securities regulators and delegation of their powers, especially in the US, see Michael Moran, 'Theories of Regulation and Changes in Regulation: The Case of Financial Markets', *Political Studies,* vol 34, (1986), pp. 185–201, particularly p. 200.

[106] Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations*, ed. Edwin Cannan (New York, 1937), p. 250.

[107] Interview with Paul Guy.

[108] The other long-standing example is the French *Commission des Opérations de Bourse*. See Philip G. Cerny, 'The "Little Big Bang" in Paris: Financial Market Deregulation in a *Dirigiste* System', *European Journal of Political Research*, vol. 17, 2 (1989), pp. 169–92.

[109] See Susan Hart, 'National Policy and the Revolution', and Philip G. Cerny, 'The "Little Big Bang" in Paris'.

markets, but little outside.[110] Part of the problem lies in the highly technical nature of regulatory problems. Most often the public enters the debate in the aftermath of scandal[111] or following a market disruption like the 1987 market crash.[112]

Secondly, the politics of IOSCO takes place in the context of a system of competitive states where the jurisdiction of political authority and the domain of the markets coincide less and less. To a considerable extent the role of the state is obscured: the cooperative process is largely outside the direct oversight of governments. IOSCO's members are for the most part autonomous or arm's length state agencies or associations within a self-regulatory 'policy community'.[113] The membership is of course concerned about its domestic constituency, but this constituency remains largely limited to the market institutions, self-regulatory organizations, and financial institutions engaged in providing investment services. The process therefore represents an interaction of domestic private interest governments (with control over important technical expertise)[114] in the international domain,[115] and not the traditional democratic process involving society at large. IOSCO represents a political process going on in the international domain, with as its objective the establishment and facilitating of transnational securities trading and issuing, through a cooperative organization whose members operate largely on a grant of authority from their respective states.

In keeping with this image, IOSCO and its membership themselves portray the organization's work as an apolitical problem for technicians which governments should keep out of. This attitude, epitomized in the quotation about keeping governments at bay at the outset of this paper, is closely related to the self-regulatory tradition in many national securities markets: 'the pressures of internationalisation have fostered the emergence of a nascent international governing system that is modelled on the private interest government approach found in the Anglo-American democracies'.[116] IOSCO agreements commit national political systems to structural

[110] See IOSCO, XVIIth Annual Conference, London, 25–29 October 1992, 'The Role of Practitioners and Self-Regulatory Organisations in the Regulation of Financial Services', papers by Sir Andrew Hugh-Smith (Chairman, London Stock Exchange), Bruno de Maulde (President, *Conseil des Bourses de Valeurs*, Paris), John Langton (Chief Executive and Secretary General, International Securities Markets Association), and David S. Ruder (Chairman, IOSCO Consultative Committee and former SEC chairman).

[111] See Michael Moran, last chapter and *passim, The Politics of the Financial Services Revolution*.

[112] Once again, the US Securities and Exchange Commission is a case in point. The Chairman of the SEC, Richard Breeden, was constantly before Congress in hearings on issues about the 1987 crash, money laundering, and so on. The SEC also presents an annual report to the joint houses of Congress. See United States, Securities and Exchange Commission, *Annual Report*, 1990.

[113] As mentioned, the large majority of the membership consists of independent securities regulatory agencies (see above, section 2.b.). See also IOSCO, *By-Laws of the International Organisation of Securities Commissions*, Washington, DC, September 1991.

For literature on policy communities, see William D. Coleman and Grace Skogstad (eds.), *Policy Communities and Policy-Making in Canada* (Toronto, 1990), particularly preface, introduction, chapter 1 and conclusion (by Coleman and Skogstad).

[114] Even securities regulators admit to difficulties understanding rapidly changing trends in the market. Only specialized market makers have the expertise required.

[115] While there is a substantial literature on aspects of private interest government (for example, W. Streeck and P. Schmitter, *Private Interest Government*), there is essentially a void when it comes to exploring this concept in the international domain.

[116] William D. Coleman, 'Keeping the Shotgun behind the Door: governing the securities industry in Canada, the United Kingdom, and the United States', in J. Rogers Hollingsworth, Wolfgang Streeck, and Philippe Schmitter (eds.), *Governing Capitalist Economies: Performance and Control of Economic Sectors* (New York, 1994), pp. 244–69.

market change which, it has been argued, has important implications for the capacity of governments to determine the direction of macro policies and shape their respective societies in accordance with the expressed preferences of the electorate as it responds to the platforms of different political parties. Governments face constant difficulties when attempting to embark on a policy course which displeases the markets. Due to the problem of capital flight in an open, market-oriented financial order, there is strong pressure for policy cooperation leading to the harmonization of macro policies along the lines of financial orthodoxy and tight money.[117] Philip Cerny has referred to this as the 'embedded financial orthodoxy' of the emerging international economic order,[118] an orthodoxy which risks becoming an 'embedded austerity'.

In sum, IOSCO combines a self-regulatory tradition in a *non-governmental* international organization. It is separated off from the sorts of domestic policy processes which one normally associates, for example, with the politics of the international trade regime. What is being implied is that, insofar as the states in the system are democratic in some way or other, and insofar as it is generally accepted that states should legitimately act as the political forum which shapes the destiny of the societies to which they are responsible, there is an accountability or legitimacy problem.[119]

Political legitimacy and 'marketization'

The final point concerning political legitimacy and accountability has more to do with the relationship of politics to markets. While political decision-making, at least in the larger sense, may be involved in establishing the original market framework, markets by their very nature require a significant grant of autonomy to the market actors (firms). This is not of course particularly unusual in many economic sectors, but capital markets are not sectors like any other. The securities industry, representing long-term capital markets, is closely linked to control over the investment process. It is increasingly bound up with international banking due to the desegmentation of the financial services industry. Control over capital has often proved vital to the process of economic development.[120] Furthermore, the IOSCO process involves transnational 'marketization' outside the jurisdiction of any sovereign authority, i.e. a grant of autonomy to market actors outside the purview of any accountable political process. They are not integrated into any national or supranational political community, and in fact are perfectly capable of playing off

[117] See Michael C. Webb, 'International Economic Structures . . .', pp. 313–21.

[118] Philip G. Cerny, 'The Infrastructure of the Infrastructure? Towards "Embedded Financial Orthodoxy" in the International Political Economy', in Barry Gills and Ronen Palen (eds.), *Transcending the State: The Neo-Structuralist Agenda in International Relations* (Boulder, CO, 1994).

[119] William Coleman has raised this question of accountability with respect to the issue of monetary policy in a domestic political context: see Coleman, 'Monetary Policy, the Bank of Canada, and Responsible Government: A Re-examination of the Issues', paper presented to the Canadian Political Science Association, University of Victoria, Canada, 27–29 May 1990.

[120] See John Zysman, *Governments, Markets, and Growth: Financial Systems and the Politics of Industrial Change* (Oxford, 1983).

one jurisdiction against another in a system of competitive states. If much of post-war economic success was closely related to the ability of national authorities to marshal economic resources for national economic development,[121] then losing the ability of national authorities substantively to affect the investment process may be problematic. If markets are created across borders, then responsible political communities may have little real influence over a vital segment of economic activity.[122] 'More than class, the major specific institutional barrier to fuller democracy may therefore be the autonomy of the private corporation.'[123]

Of course, this process of transnational marketization does not take place in a political vacuum: it is in the material interest of the major market players (Adam Smith's 'dealers') that the market should be so (re)structured.[124] In addition, states are interested in encouraging restructuring to enhance the competitiveness of their respective financial institutions and financial market-places.[125] Market structure, however, in turn constrains the political and economic choices of us all. In this sense, international markets pose an accountability problem, particularly where the control of money is concerned. This problem is already encountered in a domestic context where the deregulation and desegmentation of the financial services industry have been pursued. The management of risk in financial markets becomes less a matter of regulatory control of the specific activities of financial institutions and more to do with market discipline, which requires a new, more liberal framework of rules and disclosure requirements for firms in the business.[126] However, the *consequences* of a major market failure in a financial system where desegmentation has occurred, and wherein spillover from one interpenetrated financial market to another is a real possibility, are of considerable public interest concern,[127] the worst case being a monetary collapse of 1930s proportions.[128] Yet greater marketization implies less public control in important respects: excessive public disclosure of

[121] Examples such as France, Japan, and more recently the NICs (Korea, Taiwan) come to mind.

[122] John Zysman, in *Governments, Markets, and Growth* (London, 1983), argued the importance of the financial system and state control over investment in the process of successful economic adjustment.

[123] Charles E. Lindblom, *Politics and Markets* (New York, 1977), p. 356. The point is that a more marketized economic order enhances the autonomy of the private corporation, in contrast to a system of greater state intervention and public management of economic choices.

[124] Confidential interviews, 20 March–4 April 1992, Washington, DC; interview with Paul Guy, 10 December 1991. In the context of the European Single Market, large firms are expected to be the main beneficiaries of the market adjustment process; see Geoffrey Fitchew, Director-General of the Financial Institutions and Company Law (Commission of the European Communities), paper presented to the Centre for European Government Studies, University of Edinburgh, 15 January 1988, p. 10.

[125] What Cerny refers to as the 'competition state'; see Philip G. Cerny, *The Changing Architecture of Politics: Structure, Agency, and the Future of the State* (London, 1990), chapter 8.

[126] Susan Hart, 'National Policy and the Revolution', has argued that the City of London and the British Government only recognized the need for stricter, more rules-based supervision of the financial services sector when the traditional barriers between the segments of the industry began to break down. Prior to this, the self-regulatory system of the stock exchange and the 'moral suasion' of the Bank of England were considered sufficient.

[127] See OECD, *Banking and Monetary Policy* (Paris, 1985), and *Prudential Supervision in Banking* (Paris, 1987).

[128] It should be remembered that the segmented and tightly regulated financial services markets of the post-war period were set up largely as a response to the 1930s disaster, which was in no small way related to the interlinkages among financial sectors (banking and securities) in a domestic and international context.

market information can lead to overreaction of markets and therefore to greater instability and risk.[129]

When this situation rebounds into the international domain, where there is an absence of sovereign authority, the difficulties are complicated once again. There arises a need for international regulation on a cooperative basis. But, it has been argued, we need to look carefully at the setting in which this cooperation takes place. The European Union process of inter-governmental negotiations and limited supranational institution-building, including enhanced powers for the European Parliament through the Maastricht Treaty, seem more appropriate and accountable. None the less, we can see the legitimacy problem in the initial Danish rejection of Maastricht, reactions in the UK, and even in France and Germany. The IOSCO process is, however, considerably more distant from public debate and institutions of democratic accountability. All in all, an extensively harmonized liberal market structure may not be the most suitable institutional framework for capital markets and the control of money, given the constraints on national political communities and decision-making this implies for our societies in the absence of agreement on an effective supranational political order for capital markets. None the less, we are being propelled there with relatively little open reflection on the point. It is not a question of market vs. non-market: it is a question of *which* market structure, and *for whom*.

There is an important qualification which needs to be extended to this argument about political legitimacy. Given the problems of volatility inherent in the more market-oriented and desegmented international financial order of the sort which the IOSCO process serves to encourage, it is crucial that *someone* occupy themselves with the management of these markets. The Basle Committee has done this for banking, in a process of cooperation among central bankers. IOSCO is covering similar ground for the securities industry, including derivatives markets, in co-operation with the Basle Committee and the EU. This may represent a deficit in political legitimacy, but it can also be tenably argued that if this debate were to extend to democratic legislatures and traditional 'intergovernmental' international politics, something akin to the chaos and paralysis often seen in GATT might occur. It is difficult enough to get agreement across the board among securities regulators in IOSCO, as shall be seen below. Were this to be extended to broader discussions within democratic societies, given the interests at stake, paralysis might occur which poses an even greater danger to the financial system than the pressures of trans-nationalization and marketization.

Conclusion

IOSCO is a discreet forum in which agreements to facilitate the transnationalization of securities markets are taking shape. The structural changes in financial markets which these agreements will engender are likely to be considerable, especially if added to the transformations in capital markets which already have taken place. The

[129] OECD, 'Prudential Supervision in Banking', *Financial Market Trends*, November 1986, p. 22.

markets which are emerging pose risks for the international financial system, and constrain the decision-making of national governments. In particular, they impose market pressures on national financial strategies and will lead to the restructuring of domestic securities and capital markets. Furthermore, 'marketization' and the related desegmentation of the financial services sector pose risks for the stability of global finance.

IOSCO's membership focuses on the economic logic of capital market integration and the consequent harmonization of domestic regulatory provisions. Disagreements on issues such as capital adequacy can be significant, but the self-regulatory heritage of the important financial markets in the Anglo-American tradition and the limited nature of the IOSCO policy community have tended to obscure the political nature of the decisions made by IOSCO members. These decisions, however, *are* political and will result in changes in the pattern of gains and losses for firms in the sector, for national securities markets as they internationalize, and will lead to greater constraints for state macroeconomic policies as capital flows are further adjusted to market pressures. Internationalization also leads to greater pressure for changes in the regulatory structure leading to increased marketization of economic decision-making. Much like the rise of the Euromarkets, the internationalization of securities markets is taking place far from public debate and institutions of democratic accountability.

An examination of IOSCO in this light also permits an enhanced understanding of the relationship between politics and markets in the contemporary context. Marketization is not a spontaneous development in a separate economic domain. It does not take place in a political vacuum. While there is conflict among IOSCO members when it comes to the specific nature of agreements, there is broad agreement on the objectives to be pursued. Behind this determination lies the desire of major market actors in securities trading to improve their individual competitive positions through changes in market structure. This leads us to understand markets as institutional arrangements which confer advantages upon some and costs upon others. As such they are inherently the subject of political conflict. This conflict may be patterned in a variety of ways, but in democratic societies it is important that the process of structural market change in capital markets, with its implications for investment and economic development, take place in the framework of legitimate democratic institutions. For better or for worse, states are still the political focus of conflict over economic development and adjustment. It is important that national political communities maintain their ability to shape the process of economic development and the nature of their societies in a context of increasing transnational interdependence. There is a long-standing need to make the pressures associated with this growing market interdependence compatible with the requirements of domestic political legitimacy. A strengthening of international cooperation in processes less dominated by the particularistic interests involved is surely, despite the scepticism highlighted above, the starting point. Society need not be sacrificed on the altar of financial orthodoxy, as has happened in the late 1920s with grave consequences.