The Global Governance of Capital Flows: New Opportunities, Enduring Challenges

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Abstract

International capital mobility has long been associated with financial and banking crises. The Articles of Agreement of the International Monetary Fund contain multi-lateral rules to govern global capital flows. For some countries, especially those in the developing world, the IMF Articles of Agreement remain the core framework under which they have autonomy to regulate cross-border capital flows. For others, these rules have been partly superseded by more recent trade and other economic integration agreements. Thus what used to be a regime of 'cooperative decentralization' has become a patchwork of overlapping and inconsistent governance structures that pose significant challenges to nations attempting to regulate global capital flows for stability and growth. This paper traces the history of governing global capital flows and presents a framework for understanding three distinct eras in the modern governance of global capital. The framework emphasizes how power, interests, ideas, and institutions interact to shape each era in different combinations to yield different outcomes. From this perspective, there are many challenges ahead for effectively governing global capital flows.

JEL CODES: E65, F53, O23

I. Introduction

Since the demise of the Bretton Woods system, a system where regulations cross-border capital flows were the norm, the global community has lacked a forum for governing global capital flows. In the meantime, cross-border capital flows have increased by orders of magnitude, so much so that international asset positions now outstrip global economic output. Most cross-border capital flows occur among industrialized nations, but emerging markets with fledgling financial systems are increasing participants in the globalization of capital flows. While it is widely recognized that capital investment is an essential ingredient for economic growth, there is a growing concern that certain capital flows (such as short-term debt) can be de-stabilizing to developing country financial systems by causing asset bubbles, exchange rate appreciation during periods of massive capital inflows, that can be followed by sudden stops and capital flight that can jeopardize stability and growth (see Ocampo et al, 2006). Figure 1 shows how episodes of capital mobility have been associated with banking crises for centuries (Reinhart and Rogoff, 2009).

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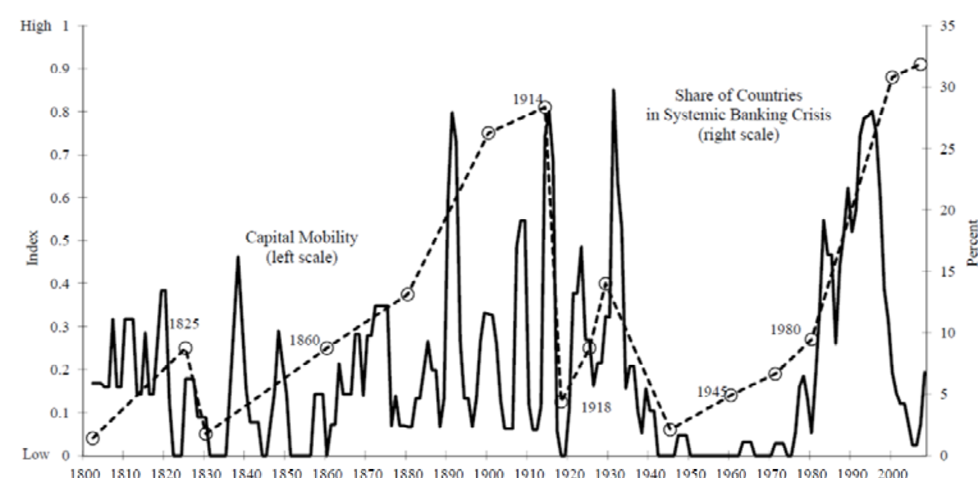
Figure 1: Capital Mobility and Banking Crises



Source: Reinhart and Rogoff (2009)

There is a long history of debate over volatile capital flows and the appropriate government policies relating to them. The global financial crisis has opened a new chapter in this debate, as pro-cyclical capital flows have been characteristic throughout (Chinn and Frieden, 2011; IMF 2010). Until very recently certain international financial institutions and strands of economic thinking have remained either hostile or silent to regulating capital movements, yet a number of emerging markets have been experimenting with national and regional level responses to volatile capital flows. In the wake of the financial crisis, international arrangements such as the G-20 and IMF are considering new roles and rules for cross-border finance as well.

Regulations to govern capital flows have traditionally been referred to as 'capital controls' but have also been referred to as 'capital management techniques,' 'capital account regulations,' and most recently 'capital flow management measures. These terms are used interchangeably in this paper to avoid redundancy. Most analysts usually differentiate between regulating on capital inflows and on outflows. Moreover, measures are usually categorized as being "price-based" or "quantity-based" controls (Epstein, Grabel, and Jomo 2008; IMF 2011). Examples of quantity-based controls are restrictions on currency mismatches, and minimum stay requirements and end-use limitations. Many of these have been used by nations such as China and India. Examples of price-based controls include taxes on inflows (Brazil) or on outflows (Malaysia). Unremunerated reserve requirements (URR) are both. On one hand they are price-based restrictions on inflows, but they also include a minimum stay requirement which can act like a quantity-based restriction on outflows.

Regulations are most often targeting foreign-currency and local currency debt of a short term nature. Foreign direct investment (except for FDI in the financial sector) is often considered less volatile and worrisome from standpoint of macroeconomic stability. Inflow restrictions on currency debt can

reduce the overall level of such borrowing and steer investment toward longer-term productive investments and thus reduce risk. Taxes on such investment cut the price differential between short and long term debt and thus discourage investment in shorter term obligations. Outflows restrictions and measures are usually deployed to "stop the bleeding" and keep capital from leaving the host nation too rapidly.

This paper traces the modern history of the governance of cross-border capital flows. The regime was one of cooperative decentralization but has emerged since the global financial crisis (GFC) is an incoherent mix of cooperative decentralization and strong international standards that may threaten the ability of nations to govern global capital effectively. Part II of the paper discusses the Bretton Woods era. Part III examines the period from the 1970s until the Asian Financial Crisis (AFC), with part IV analyzing the period from the AFC to the GFC and its aftermath. Each of these sections not only traces events, but offers an analytical framework to show how power, interests, ideas and institutions together shaped each era in different combinations to yield different outcomes.

II. Cooperative De-Centralization: Bretton Woods Era

The IMF Articles of Agreement, forged at the 1944 United Nations Monetary and Financial Conference in Bretton Woods, New Hampshire, grant nations the ability to pursue their own policies to regulate cross-border capital flows. Moreover, the Articles permit nations to cooperate internationally to enforce such regulations. For almost a quarter century after the Bretton Woods meeting this regime "functioned more or less as planned" (Eichengreen, 2008, 92).

Under the umbrella of the IMF articles, the regime for governing capital flows could be characterized as what Eric Helleiner and Stephano Pagliari (2011) term "cooperative de-centralization." Cooperative de-centralization is a financial regime where there is interstate cooperation but across a divergence of national regulatory approaches. This stands in contrast with what they term "strong international standards" that are characterized by interstate cooperation and global regulatory convergence across national systems of regulation. The IMF articles of agreement allow for national diversity in terms of regulating capital flows and permit nations to cooperate to monitor and enforce such regulations on a multi-lateral basis.

Forging the Global New Deal

The Bretton Woods conference was envisioned to result in a "New Deal in international economics" according to US Treasury Secretary Henry Morgenthau and other core negotiators at the conference (Helleiner, 2011). In that vision, the meetings yielded an IMF committed to stabilizing exchange rates and re-constructing balance-of-payments among its members.

The core framers of the IMF Articles were Harry Dexter White, who represented the United States, and John Maynard Keynes of Great Britain. The differences between these two men, and their countries, over what a post-War international monetary system should look like were notorious and large (Skidelsky, 2000). Interestingly, relatively less attention has focused on the fact that they agreed on at least two things: it was important for nations to have the freedom to regulate capital flows and that nations should cooperate in order to render those regulations effective (Thirwall, 74; Helleiner, 1994; Abdelal, 2007).

Both Keynes and White saw capital flows as concerning. For White the need to regulate capital flows was seen as a "second-best" strategy, for Keynes capital controls were second nature (Boughton, 2002). Both men saw the need to regulate speculative capital flows because of the impact that such flows could have on the policy autonomy of the welfare state and on exchange rate stability (Helleiner, 1994). Although the formal Mundell-Fleming model had not yet been articulated, these economists had insight to see that the free movement of capital was not compatible with a fixed exchange rate and an independent monetary policy. The free movement of capital can throw off the ability of nations to expand and contract their economies. In such an environment lowering the interest rate to expand the domestic economy could trigger capital flight rather than domestic investment; raising rates could attract evermore capital at exactly the time when cooling off an economy is called for. Such pro-cyclical capital flows also put real pressure on the exchange rate and can cause balance of payments problems. This concern was echoed by a famous League of Nations report largely written by another well-known economist of the times, Ragnar Nurkse (League of Nations, 1944).

Thus the framers of the IMF saw capital controls as core to sustaining the international monetary system. What is more, they did not see unilateral regulation as sufficient to help nations have policy autonomy and maintain stable exchange rates. White said "without the cooperation of other countries such control is difficult, expensive, and subject to evasion" (quoted in Helleiner, 1994, 38). Keynes put it this way, "but such control will be difficult to work, especially in the absence of postal censorship, by unilateral action than if movements of capital can be controlled at both ends" (quoted in Obstfeld and Taylor, 2004, 149). Indeed, both men articulated that nations be required to cooperate with each other's capital controls under the auspices of the agreement. After fierce push-back by Wall Street interests however, notions of "requiring" cooperation became watered down to simply permitting such cooperation (Helleiner, 1994; Abdelal, 2007).

Box 1: Capital Controls in the IMF Articles of Agreement

Article VI: Capital Transfers

Section 1. Use of the Fund's general resources for capital transfers

(*a*) A member may not use the Fund's general resources to meet a large or sustained outflow of capital except as provided in Section 2 of this Article, and the Fund may request a member to exercise controls to prevent such use of the general resources of the Fund. If, after receiving such a request, a member fails to exercise appropriate controls, the Fund may declare the member ineligible to use the general resources of the Fund.

b) Nothing in this Section shall be deemed:

(i) to prevent the use of the general resources of the Fund for capital transactions of reasonable amount required for the expansion of exports or in the ordinary course of trade, banking, or other business; or

(ii) to affect capital movements which are met out of a member's own resources, but members undertake that such capital movements will be in accordance with the purposes of the Fund

Section 3. Controls of capital transfers

Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(*b*) and in Article XIV, Section 2.

Article VIII: General Obligations of Members

Section 2. Avoidance of restrictions on current payments

(b)Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

Section 5. Furnishing of information

(a)The Fund may require members to furnish it with such information as it deems necessary for its activities, including, as the minimum necessary for the effective discharge of the Fund's duties, national data on the following matters:

(vi) international balance of payments, including (1) trade in goods and services, (2) gold transactions, (3) known capital transactions, and (4) other items;

(xi) exchange controls, i.e., a comprehensive statement of exchange controls in effect at the time of assuming membership in the Fund and details of subsequent changes as they occur;

Source: IMF, 2012

Box 1 reproduces the key components of the Articles of Agreement that pertain to global capital flows. The clear language granting nation-states the ability to deploy capital controls is found in Article VI, Section 3: "Members may exercise such controls as are necessary to regulate international capital movements." Article VI, Section 1 allows the IMF to request that a nation put in place capital controls and even permits the Fund to withdraw support if such a request is not granted. In Article VIII, Section 2 (b) one can find the language on cooperation: "members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective." This language does not "require" cooperation as White and Keynes had hoped, but does stress the importance of cooperation. Other parts of Article VIII, in Section 5, grant the IMF authority to collect data on both capital flows and on the nature of capital controls—thus arming them with the information that individual nations will not have and therefore helping nations identify the sources of capital flows and where to turn for cooperation.

Capital Flows and the Golden Age of Capitalism

As noted earlier, scholars generally agree that the regime of cooperative de-centralization for governing capital flows worked "more or less as planned" during the Bretton Woods era, but began to break down in the 1970s. A large number of nations, including the United States, deployed capital controls during this period with some success. And, though in a more limited fashion than White and Keynes would have hoped, there was a certain degree of international cooperation as well.

The earliest examples of cooperation on capital account regulations occurred between 1944 and 1947. During that period a number of bi-lateral agreements between Great Britain and a number of European countries included cooperation on capital controls among countries. However, Europeans were rebuked when they requested that the US regulate inflows of capital from Europe in order to stem capital flight from Europe to the US during that period because of the interests of the US banking community. Yet, Helleiner (1994) argues that there was implicit cooperation on the part of the United States during the period because the US sent a significant amount of capital back to Europe in the form of the Marshall plan.

The 1960s have been characterized more as a period of unilateral forms of regulation though in some ways they could be seen as "coordinating" rather than explicit "cooperating." During this period the US was engaged in expansionary monetary policy and was concerned that low interest rates would trigger excessive capital outflows. European nations were battling inflation and were concerned that high interest rates might attract more capital at exactly the time when they wanted to cool their economies. Many European nations thus regulated the inflow of speculative capital while the US regulated capital outflows. And the US pushed the Canadians (who were exempt from US controls on outflows) to "plug the whole" that allowed US capital to leak to Europe through the Canadian exception to US regulation (Hawley, 1997). Aside from the US-Canada case, Helleiner (1994) has studied this period the closest and does not indicate that these nations explicitly cooperated on regulating capital flows. However, the US and Europe effectively had coordinated actions given that they put controls on "both ends" as Keynes had suggested.

It may come as a surprise to many to learn that the United States fairly successfully deployed capital controls during the Bretton Woods era. The US regulated outflows of speculative capital for close to ten years, 1963 to 1973. And for a very brief period regulated inflows as well.

Between 1969 and 1970 capital inflows from the Euromarket were making it difficult for the Federal reserve to limit domestic credit. Thus in 1969 the Federal Reserve restricted the ability of Eurodollar borrowing by US banks. First the Federal Reserve attempted to have US banks do this on a voluntary basis, but then officially put a ten percent reserve requirement on domestic borrowing from US banks in the Euromarket. The Fed attempted to establish a reserve requirement in 1979 as well. Moreover, the Federal Reserve pushed hard for the Bank of International Settlements to require that nations cooperate with these the US proposal. Both these later efforts failed (Helleiner, 1994).

The most significant capital controls in the US were controls on outflows. In the 1960s the US was engaged in expansionary monetary policy (and ramping up for the Vietnam War) but was also experiencing balance-of-payments problems (Block, 77). After weighing a series of alternative policies the US enacted the Interest Equalization Tax (IET). The IET was a 15 percent tax on the purchase of foreign equities. For bond trades the tax variety depending on the maturity structure of the bond, ranging from 2.75 percent on a three year bond and up to 15 percent on a 28.5 year bond. Borrowers looking to float bonds would thus pay approximately one percent more than interest rates in the US, thereby flattening the interest rate differential between the United States and Europe (Hawley, 1987).

The US was very shrewd in designing the IET so as to get the act passed by the United States Congress. A number of factors have been attributed to this feat. First, the tax was specific to portfolio flows and not also to multi-national corporations headquartered in the United States. Thus there was not a "coalition of capital" against the legislation among finance and industrial capital. Second, investors had two options that eased the pain: lucrative domestic market alternatives and the Euromarket in London. Third, the US government still operated under a Keynesian rubric that saw regulating capital flows as legitimate. Moreover, by deploying a market-based tool rather than outright quantitative tools the US wanted to show other nations that capital could be regulated in a more market-friendly manner (Conybeare, 1988; Hawley, 1987; Helleiner, 1994).

The IET immediately changed the composition of US outflows of capital but took longer to effect the balance of payments. In an early study Richard Cooper concluded that "The IET was highly successful in its narrow objective; taxable new foreign issues in the United States virtually ceased, and net acquisitions of outstanding foreign securities by Americans became fairly substantial net liquidations after the tax proposal." (Cooper, 1965, 469) However, Cooper went on to note that the IET had not, by 1965, shown up as a significant change in the US balance of payments position. However, a later analysis from the US Congress concluded:

> "The Interest Equalization Tax was first made effective in the middle of 1963 and used in conjunction with the limitations on extensions of credit and direct balance of payments problem. Measured on a liquidity basis, the deficit fell from an average of 2.5 billion dollars in the years 1961 through 1964 to 1.3 billion dollars for 1965 and 1966. In 1967 the deficit

increased to 3.5 billion dollars and in 1968 a surplus of 93 million dollars was recorded." (Butterworth, 1970, 172).

Despite the limited level of cooperation, numerous studies show that capital controls were effective outside the US during this period as well. Work by Obstfeld (1993), Marston (1993), and Kouri and Porter (1974) demonstrated how controls were effective to the 1960s in the United Kingdom, Germany, Australia, Italy, and the Netherlands.

As the Bretton Woods system of exchange rates began to unravel in the 1970s there was a last round of cooperation that led Europe to push for explicitly granting the IMF more power to mandate cooperation on capital controls as Keynes and White had once urged. France convinced the United States to maintain its capital control on outflows in the 1970s so France wouldn't suffer the currency appreciation of heavy inflows of capital from the US. During the same period France convinced Germany to tighten capital controls on outflows in order for France not to suffer the consequences of excessive inflows of speculative capital. Such efforts did not last long and efforts to reinstate 'requirements' to cooperate were neutralized by the US banking community (Helleiner, 1994; Webb, 1995; Chwieroth, 2010).

The Political Economy of Regulating Capital in the Bretton Woods Era

The events discussed thus far confirm what scholars such as Eichengreen (2008) have said, which is that capital controls "worked more or less as planned" during the Bretton Woods era. But why and how? Political power, interest group politics, and prevailing economic ideas and thinking about government all in a particular institutional setting each integrated to make the Bretton Woods era a unique period in the modern history of governing capital flows.

Table 1

The Political Economy of Regulating Cross-Border Capital Flows

	Bretton Woods	1970s to AFC	AFC through GFC
Power	US as 'benevolent' hegemon	US (and EU) Financial Hegemony	Multi-polarity
Interests	Industry-Labor alliance	Finance-Industry alliance	varies by country
Ideas	Keynesian economic Embedded liberalism	New Classical economics Neo-liberalism	New/Post-Keynesian? hybrid varieties of liberalism
Institutions	Cooperative de-centralization *(IMF Articles of Agreement)*	Strong international standards *(OECD, etc)*	Overlapping (and conflicting) regimes *(IMF Articles and Trade-Integration regime)*

Table 1 depicts how these forces interacted during the Bretton Woods era as contrasted with the neo-liberal period following Bretton Woods and from the Asian Financial Crisis (AFC) to the Global Financial Crisis (GFC). What characterizes the Bretton Woods era is that the US was a 'benevolent' hegemon, that the financial sector in the US was not as strong as in later periods, that Keynesian ideas prevailed during the period and the world largely operated under the rubric of the IMF articles.

In terms of power, Helleiner (1994) has depicted the US as a 'benevolent' hegemon with respect to capital controls. The U.S. permitted capital controls in other nations because of cold war concerns. Policy-makers in Japan and Europe saw controls as essential to their growth strategies and the U.S. saw enabling growth and maintaining alliances with those nations as a high priority. Moreover, as we saw above, the US itself deployed controls for over 10 years during the period.

It is also important to note that interest group politics in the US were starkly different than in later periods. Domestic employment and production was the center of US economic policy. Therefore there was an implicit industry-labor alliance. Firms relied on aggregate domestic demand for profit and production and therefore expansionary domestic policy unfettered by external shock was seen as in the interests of labor and capital alike (Ferguson, 1995). What is more, the entire US financial system was geared toward supporting domestic demand and thus the financial sector also had a stake (Eichengreen, 2008). Finally, investors did have the option of the Euromarket and were able to water down the requirements on cooperation in the IMF articles (Helleiner, 1994).

In terms of ideas, the construction of the Bretton Woods system reflected the prevailing mode of thought (at least in the UK and U.S. where the institutions were framed) of 'embedded liberalism'—the dominant thinking about political and economic organization at the time that stressed that markets were imperative but they needed to be 'embedded' in proper institutions for them to be welfare enhancing (Ruggie, 1982). "Embedded liberals argued that capital controls were necessary to prevent the policy autonomy of the new and interventionist welfare state from being undermined by speculative and disequilibrating international capital flows" (Helleiner, 1994, 4). This thinking was backed by a coalition of Keynesian-minded policy-makers, industrialists who gained from such policy, and labor leaders. Indeed, this period is seen as the heyday of the "Keynesian Revolution" in economics.

The institutional backdrop for the Bretton Woods era of course were the IMF Articles of Agreement. These articles allowed for a regime of cooperative decentralization that did not live up to its full promise but did indeed operate. Nations deployed a wide variety of regulations to regulate the inflow of capital, sometimes at "both ends" and sometimes in cooperative fashion.

II. The Push for Strong International Standards: 1970s to the Asian Financial Crisis

By the 1990s industrialized countries had shifted their thinking and action on global capital flows, with most fully opening their capital account. These unilateral actions reflected new thinking in macroeconomics and strong financial interests that began to see capital account regulations as barriers to entry in foreign markets. Industrialized nations moved to formalize this thinking through "strong international standards" on all fronts—at the OECD, at the IMF, and beyond.

The results have been sweeping in the industrialized world but only partially transforming among emerging market and developing countries. OECD nations now have a clear mandate for capital

account liberalization. An attempt was also made to change the IMF Articles of Agreement to mandate capital account liberalization in the 1990s, though that initiative did not materialize.

The Organization of Economic Cooperation and Development (OECD)

Informally, many individual countries began advocating for capital account liberalization in the 1970s but the first formal adoption of such standards are the OECD codes[2]. Somewhat analogous to the IMF articles, speculative capital was initially excluded from the original (1964) Codes on grounds that short-term capital would disrupt the balance of payments position of OECD members and make it difficult for nations to pursue independent monetary and exchange rate policies. The original codes were ammended in 1989 when a group of nations led by the UK and Germany argued that all OECD nations by then had sophisticated enough capital markets that they could withstand liberalization of short-term flows. The amendment requires capital account liberalization and a prerequisite for OECD accessing. Indeed, all nations that acceded to the OECD since 1989, regardless of their level of development, also liberalized their capital accounts to include short and long-term maturities. South Korea, in its accession negotiations in 1996 argued that it should have a grace period to gradually open their capital account as they developed. The OECD denied this request, conditioning membership on an open capital account and South Korea conceded (Abdelal, 2007).

Alongside the broad mandates for OECD countries there are also fairly broad exceptions. Article 7 (in each set of Codes) holds the "clauses of derogation" that govern the temporary suspension of commitments. Under these safeguards a nation may suspend liberalization. Article 7b allows a member to put in place temporary capital controls to stem what may "result in serious economic disturbance in the Member State concerned, that Member may withdraw those measures." Article 7c is the balance-of-payments exception "If the overall balance of payments of a Member develops adversely at a rate and in circumstances, including the state of its monetary reserves, which it considers serious that Member may temporarily suspend the application of measures of liberalisation taken." (OECD, 2009). Greece, Iceland, Portugal, Spain, and Turkey have all used the derogation. The OECD permitted them to do so because these nations were seen to be at a lower stage of development relative to the other members of the OECD (Abdelal, 2007).

Rethinking Capital Controls at the IMF

Beginning in the 1970s the IMF was transformed as well. What was once at the core of the international monetary system—regulating capital flows to maintain policy autonomy and stabilize exchange rates—began to be seen as heresy. Initially the transformation was informal, with a shift in IMF staff and board thinking and thus a different level of surveillance and advice for member countries. In the mid-1990s the IMF proposed to formally amend the Articles of Agreement to include the liberalization of the capital account. According to an IMF staff report, "the impetus for such liberalization was largely provided by the frameworks of the OECD Code and the EU Directives." (Quirk, 1995, 6). This would have amounted to a revision of Article VI that grants nations the ability to regulate

[2] The European Union formalized capital account liberalization in 1988, this essay focuses on "global" economic governance spanning more than one continent.

capital flows. These formal efforts did not materialize but capital market liberalization remains as a dominant view at the fund to this day.

Although the IMF had no legal authority to force nations to liberalize their capital accounts, IMF staff and the strongest members of the board changed their thinking and began changing the advice they gave to member states during the 1970s and 1980s. According to the Independent Evaluation Office of the IMF, the IMF did not require nations to open their capital account as part of the conditionality of a financial program. Indeed, the IMF's own interpretation of the Articles of Agreement is that the Fund cannot "require a member to remove controls on capital movements" (see IMF, 2005, p31). Rather, the IMF began to encourage liberalization through letters of intent and policy memorandum not officially part of official financial program documents. The Exchange and Trade Restrictions department of the IMF recommended capital account liberalization in Nigeria, Guatemala, Egypt, Honduras, Jamaica, and elsewhere. What's more, capital account liberalization in the IMF's annual World Economic Outlook reports and other publications. Chwieroth (2010, 152) says "controls were said to harm economic performance, create severe distortions, and delay policy adjustments needed to eliminate balance of payments disequilibria." Joyce and Noy (2008), econometrically show that such advice was taken--between 1982 and 1998 capital account liberalization was significantly correlated with a nation having an IMF financial program.

Attempts to formalize the new thinking about regulating capital flows at the IMF date back to the early 1970s, and were led by the United States. Thus in 1972 the IMF created a Committee of Twenty (C-20) to put together proposals for reform and in 1973 "The Report of the Technical Group on Disequilibrating Capital Flows" was submitted to the C-20 (Pauly, 2008). Foreshadowing events in 2011, the Technical Group Report recommended that the IMF construct a "code of conduct" for the use of capital controls. The final C-20 report that formed the basis for later ammendments to the IMF did not include that recommendation, but the US influence led the report to state that "countries will not use controls over capital transactions for the purpose of maintaining inappropriate exchange rates, or more generally, of avoiding appropriate adjustment action " (quoted in Chwieroth, 143). However, though the final ammendments "legalized" floating exchange rates, consensus on capital controls and capital account liberalization was elusive so the original Articles, and thus the regime of cooperative de-centralization for non-OECD members, remained intact.

In the wake of the Asian crisis, the IMF's policy stance on capital account liberalization remained fully supportive of capital account liberalization, though it still lacks the legal authority to mandate such liberalization. However, the Fund also recommends that the liberalization of the capital account should be gradual, and sequenced—a stark contrast to the "big bang" approach of rapid liberalization that dominated the Fund during the run to change the Articles (Chwieroth, 2010). Finally, the Fund recognized that temporary capital controls can be a part of the transition to eventual liberalization and at least partially supported the use of capital controls in many countries starting in the 1990s (IMF, 2010).

The Political Economy of Capital Account Liberalization

How did such a radical change in global policy come about over a relatively short period of time? One of the core principles of the Bretton Woods agreement was the ability of nation-states to regulate capital flows as they saw necessary. Moreover, nations were free to cooperate amongst each other in order to make such regulations effective. Beginning in the 1970s the tables completely turned, and capital account liberalization became 'the norm,' at least across the industrialized world.

Revisiting Table 1, a confluence of factors integrated to cause one of the most decisive shifts in modern global monetary history. US foreign economic power (with the EU close by) dominated because of a mix of newfound economic ideas that tightly aligned with the emergence of financial interest groups. In parallel the IMF became stocked with these new economic ideas and became under new management strongly committed to globalizing financial flows in the world economy. This convergence of interests and ideas gave the IMF, the US and other industrialized countries the power to forge a set of strong international standards that replaced the regime of cooperative decentralization before it. Though many countries, at least 100, still operate under the IMF and free of these strong international standards, their position may be significantly weakened, and temporary.

With respect to interest group politics, a number of authors note the rise of a "Wall Street/Treasury Complex," that came to dominate US foreign economic and even the IMF. Cohen (2008) illustrates that while the costs of capital controls are directly felt by a handful of politically organized US constituents—Wall Street—the beneficiaries are diffuse and don't feel the direct effects. Thus a collective action problem persisted where Wall Street organized around capital account liberalization. Voices as diverse as Robert Wade (1998) and Jagdish Bhagwati (2004) went on to term a "Wall Street-Treasury complex" (analogous to the "military industrial complex coined during the Eisenhower era to describe politics of that time). These authors argued that the US Treasury and Wall Street investment houses pushed for the freedom of capital movements wherever possible, including forcing the IMF into pushing capital account liberalization worldwide and working to mint such a policy in the IMF articles. Other authors such as Kirshner (2003), Blyth (2003) and Moschella (2011) see interests group as key in shaping the change, but offer a more nuanced view of the role that interests interacted with ideas.

In terms of ideas, economic theory went through a fundamental revolution in macroeconomics where Keynesian economics was replaced with New Classical macroeconomics . These economists, later joined by "New" Keynesian economists saw capital flows as generally a good thing. This new thinking in macroeconomics formed a backdrop for a different way of thinking about government altogether—commonly referred to as the neo-liberal era, rising with the arrival of Ronald Reagan and Margaret Thatcher in 1979-80 and cresting with the 'Washington Consensus' advocated by the US, Europe and the IMF throughout the 1990s. In general, this era could be characterized as seeing an extremely limited role for the state in economic affairs, and the principal role of politics was to carry out that economic view. Mark Blyth (2002) traces the shift from embedded liberalism to neo-liberalism in the 1970s. He writes:

> In sum, just as labor and the state reacted to the collapse of the classical liberal order during the 1930s and 1940s by re-embedding the market, so business reacted against this embedded liberal order during the 1970s and 1980s and sought to "disembed liberalism" once again. In this

effort, business and its political allies were quite successful, and by the 1990s a new neoliberal institutional order had been established in many advanced capitalist states with remarkable similarities to the regime discredited in the 1930s (Blyth, 2002, 6).

In the case of the IMF Abdelal, (2007) argues that this change was in part imported to the IMF from the French. French socialists were originally big advocates of capital controls. However, controls on outflows in 1983 adversely affected the middle class and led to a change in the party stance. When Michel Camdessus (a prominent French Socialist at the time) became IMF Managing Director he met a highly sympathetic staff at the IMF and began to work together with them toward the liberalization of capital controls. Chwieroth (2010) acknowledges that the French connection was important, but stress how the agents—the IMF staff that sponsored the prevailing economic thinking of the time—where key advocates. In its early days, most IMF staff were Keynesians who supported capital controls, but slowly the IMF became populated with US-trained economists of the neo-classical synthesis or new classical economics who saw capital controls as counter-productive. Chwieroth finds however that there were tensions between "gradualist" and "big-bang" camps at the Fund. Gradualists advocated for gradual capital account liberalization and the selective use of capital controls and big bang advocates wanted rapid liberalization of the capital account. The IMF is largely seen as a big bang advocate, especially to casual observers who saw the IMF looking to change its charter to mandate capital account liberalization and those who observed IMF country programs where capital controls often had to be eliminated on condition of an IMF loan. Chwieroth shows that this wasn't necessarily the case. Gradualists and big bang advocates at the IMF struck a compromise on capital controls controls. By the end of the 1990s the IMF was pushing for capital account liberalization but tacitly supporting limited and temporary controls as safeguard measures in crisis mitigation on the road to liberalization.

Corresponding with Table 1, this period is characterized as a shift from embedded liberalism to neoliberal thought in general, and the dominance of a particular brand of neo-classical economics that supported a very limited role of the state in economic affairs in particular. In addition, whereas the US and IMF had seen it as advantageous to support capital controls in the earlier era, with the Cold War no longer driving US financial strategy, the US was now gaining a comparative advantage in global financial services and saw capital account liberalization as advantageous to key constituencies in the U.S. The financial sector played a key role in US administration and the US and EU, alongside the IMF was able to codify capital account liberalization at the OECD and at least restrict capital controls through a number of global and regional trade and investment treaties. They were not successful however in making a global mandate for capital account liberalization through changes in the Articles of Agreement to the International Monetary Fund.

The East Asian financial crisis in 1997 put an end to discussions of changing the IMF's articles of agreement to include capital account liberalization. A number of developing countries and emerging market economies were giving the IMF and US supporters stiff resistance from the beginning. Yet the Asian crisis was seen by many to be in large part due to too rapid of a liberalization of Asian capital accounts, or what the IMF referred to as 'disorderly liberalization." At the same time, numerous economic studies including the IMF's own World Economic Outlook began to show that capital account liberalization was not associated with economic growth (Eichengreen, 2004, IMF, 2005; Ocampo and Stiglitz, 2008). Moroever, many civil society organizations based in Washington began to ally with their

developing country counterparts and put pressure on the US Congress to block the initiative (Chwieroth, 2010).

IV. *Regaining Control? Regulating Capital Flows and Global Financial Crises*

The Asian Financial Crisis and other crises during the late 1990s in Brazil, Russia, and Argentina led to a fundamental change in the way emerging market nation states came to view capital account liberalization. The IMF also tempered and clarified its institutional view on capital account liberalization and capital controls, and the G-20 has played a catalytic role as well. During this period there were breakthroughs in economic theory and evidence that questioned capital account liberalization and justified capital controls. Alongside this change however, a patchwork of global and regional trade treaties emerged that require some capital account liberalization and limit the ability to regulate cross-border finance. A hybrid regime of cooperative decentralization and strong international standards has emerged.

Resurgence of Capital Controls from the AFC to the GFC

In response to the AFC and other crises of the 1990s many nations sought to 'self insure' from having to resort to the IMF by accumulating foreign exchange reserves and deploying capital controls (mostly on inflows). A large body of research shows that those efforts were effective in maintaining macroeconomic stability during one of the largest periods of emerging market growth in history. Moreover, newer research shows that such efforts in part explain why emerging market and developing countries were among the least hard hit during the GFC.

A near consensus emerged at the turn of the century among empirical neo-classical macroeconomists that capital market liberalization in developing countries is not associated with economic growth in developing countries (Prasad et al. 2003; Jeanne et al, 2012). Indeed, the most recent research has shown that capital market liberalization is only associated with growth in nations that have reached a certain institutional threshold—a threshold that most developing nations are yet to achieve (Kose, Prasad, and Taylor 2009). This is partly due to the fact that the binding constraint for some developing country growth trajectories is not the need for external investment, but the lack of investment demand. This constraint can be accentuated through foreign capital flows because such flows appreciate the real exchange rate thus reducing the competitiveness of real economy goods and reducing private sector willingness to invest (Rodrik and Subramanian 2009).

Many developing nations deployed capital controls between 2002 and 2007 and controls seemed were part of the reason why developing countries were not as hard hit during the GFC. This became confirmed in a February 2010 IMF Staff Position Note, the IMF staff reviewed all the evidence on capital controls on inflows, pre and post crisis and concluded: "capital controls—in addition to both prudential and macroeconomic policy—is justified as part of the policy toolkit to manage inflows. Such controls, moreover, can retain potency even if investors devise strategies to bypass them, provided such strategies are more costly than the expected return from the transaction: the cost of circumvention strategies acts as "sand in the wheels" (Ostry et al, 2010). To come to this conclusion, the IMF study reviews the experiences of post-Asian crisis capital controls. The econometric analysis conducted by the IMF examined how countries that used capital controls fared versus countries that did not use them in the run-up to the current crisis. They found that countries with controls fared better: "the use of capital

controls was associated with avoiding some of the worst growth outcomes associated with financial fragility" during the global financial crisis (Ostry et al, 2010: 19). The IMF report echoed a less publicized but even more legitimate assessment of the capital controls literature by the National Bureau of Economic Research in the US that not only examined the literature but weighted its findings by the rigor of the analyses conducted. That report, published in 2006 and updated in 2011 concluded: "in sum, capital controls on inflows seem to make monetary policy more independent, alter the composition of capital flows and reduce real exchange rate pressures." In terms of outflows, say the authors, "it is clear that such provisions were successful in Malaysia, but it is not so clear about the case of other nations" (Magud et al, 2011).

As the GFC accentuated developed nations experienced low interest rates and slow growth while developing countries had relatively higher rates of interest and growth. This triggered a new wave of capital inflows to developing countries that caused significant currency appreciation and asset bubbles. Indeed, Brazilian President Dilma Rouseff referred to these inflows as a "liquidity tsunami," as she toured the world in 2011 and 2012 pointing to developed countries to limit the outflow of capital from their nations. It is no surprise that the loudest cry came from Brazil, that experienced an over 40 percent appreciation between 2009 and 2011 and a stock market bubble as well. In response, Brazil has deployed numerous taxes and other limits on stocks, bonds, and derivatives positions. With the exception of Brazil, the nations that have received the most attention for deploying capital controls are in East Asia. Brazil, South Korea, and Taiwan have been the most aggressive in deploying controls. A number of analyses have shown that these recent efforts have also been effective, despite the fact that there has been no coordination or cooperation across borders during the GFC period on controls whatsoever (IMF, 2011; Gallagher, 2011; Forbes et al, 2011; Bauman and Gallagher, 2012).

The IMF, Capital Controls, and the GFC

Following the AFC the IMF took a more gradual approach to capital account liberalization and even supported the use of capital controls in some occasions. After the GFC the IMF clarified that position with an 'institutional view' on liberalization and regulation, and went beyond supporting capital controls to recommending them. In 2005 the IMF's Independent Evaluation Office conducted an assessment to evaluate and synthesize the IMF's approach to capital account liberalization from the AFC to 2004. The IEO concluded that IMF position began to evolve after the AFC. In contrast to the 1990s, the IMF's policy stance on capital account liberalization can now be summarized as fully supportive of capital account liberalization. However, the Fund also recommends that the liberalization of the capital account should be gradual, and sequenced. Finally, the Fund recognizes that temporary capital controls can be a part of the transition to eventual liberalization (IMF, 2010). The report notes that the IMF supported the use of capital controls in seven of the twelve countries that the IMF assisted in the 1990s. Indeed, in two countries, Peru and Estonia in the 1990s, the IMF actually advised nations to impose capital controls as part of their IMF financial programs.

After the GFC this little known change became accentuated and clarified. From the AFC until the onset of the GFC regulating capital flows was a quiet undertaking at the IMF. After the GFC struck in 2008 the IMF began to clarify their stance on capital regulation and to become fairly vocal about that view. In addition to the staff position note discussed earlier, the IMF has reiterated its support for the use of capital controls in its *Global Financial Stability Report* and in its flagship *World Economic Outlook* (IMF 2010;Grabel, 2010). Whereas those reports discussed the need for regulating financial inflows,

during the global financial crisis the IMF also recommended or at least sanctioned controls on outflows in Iceland, Latvia, and the Ukraine (Grabel, 2010; IMF, 2012).

Evocative of the 1972 call by the US and C-20 for an IMF code of conduct (discussed earlier) that might bind nations to use "appropriate" versus "inappropriate" uses of capital controls, the IMF embarked upon creating a new code of conduct for the use of capital controls in the wake of the GFC. The code of conduct was coordinated by the IMF between 2010 and 2012 and was hotly contested. Ironically, while the code was initially proposed at the G-20, it was the G-20 that pushed back on the guidelines that were put forth by the IMF.

In 2010 French President Nicolas Sarkozy assumed a role as host and head of the G20 for 2011 -- the period of excessive capital market volatility recently discussed here. Sarkocy saw the myriad used of capital controls and called for a global code of conduct on capital controls, and tasked the IMF to propose a set of guidelines for reform:

> "A code of good conduct, strong guidelines and a common framework governing the possibility of implementing capital controls where necessary must define the conditions under which restrictions on capital movements are legitimate, effective and appropriate to a given situation. ……….In the longer term, France – and I'm saying this now – is favorable to a modification of the IMF's Articles of Agreement to broaden its supervision mandate."(quoted by Batista, 2012, 99).

Under this direction the IMF staff conducted research for the executive board, which formally endorsed a set of guidelines on inflows in April of 2011. Guidelines on capital account regulations and controls on outflows were drawn up in March of 2012 and discussed at the executive board in April 2012. The official IMF papers to this end were synthesized into a final synthesis document representing the fund's "institutional view" in July of 2012.

The IMF's guidelines on inflows recommend that countries deploy capital controls only as a last resort – that is, after such measures as building up reserves, letting currencies appreciate and cutting budget deficits. The Fund also recommends that controls not be discriminatory among residents. What is more, the IMF stopped referring to regulations as 'capital controls' and created the phrase 'capital flow management measures (CFMs)' in order to be more precise and to detach the stigma that comes with 'capital controls' (IMF 2011). Developing countries were highly concerned with the effort because it was seen as narrowing the flexibility under the Articles and leading to strong international standards. Some openly criticized the vote of endorsement, arguing that it was a vote of 'weighted majority' whereby industrialized countries that were the source of the capital outflows voted to restrict the ability of developing country recipients of the subsequent inflows to act upon them. No developing countries voted for the measure (Batista, 2012). In the cases where the IMF econometric analyses found controls to be effective, such measures were part of a broader macroeconomic toolkit, and were deployed alongside other measures – not as a "last resort".

Interestingly, whereas the entire effort was supported by the French it was on French soil where the IMF guidelines were tempered by a (non-binding) set of conclusions signed by all G-20 leaders and finance ministers. The G-20's 2011 meeting was held in Cannes during an acute period of the EUrozone

crisis that captured the attention of most negotiators. However, a working group was formed to take the capital flows issue to the highest level. Headed by Germany and Brazil, the group forged the "G20 Coherent Conclusions for the Management of Capital Flows Drawing on Country Experiences". The document was "endorsed by the G20 finance ministers and central bank governors in October, then endorsed by the G20 leaders themselves in Cannes. The effort was spearheaded by Brazil and accepted by Germany because at the Cannes meetings Germany was seeking emerging market support to build a firewall around the Eurozone to prevent further crises there. In contrast to the IMF guidelines, the G20's conclusions say that "there is no 'one-size fits all' approach or rigid definition of conditions for the use of capital flow management measures", and that such measures should not be solely seen as a last resort. Instead, the G20 now calls on nations to develop their own country-specific approach to managing capital flows.

In 2012 the IMF pushed on with the development of its guidelines, which it initially referred to as a "framework" but then became synthesized as the Fund's "institutional view." The IMF reiterates its support of capital account liberalization as a long run goal, but slightly qualifies that support relative to the IEO assessment. The IMF now states that capital account liberalization is only optimal after a nation has reached a certain threshold of financial and economic development and (echoing its past stance, 1997-2004) that liberalization should be sequenced, gradual, and not the same for all countries at all times. The IMF view is that capital controls can be part of the liberalization and sequencing. The IMF also recommends guidelines for the use of controls on capital outflows, arguing that by and large they should not be used but can be considered in crisis or near crisis conditions (IMF, 2012). Side by side with the IEO assessment the distinctions between the two are subtle, but not the IMF is fairly clear about when and why it may recommend liberalization or regulation, and has become much more openly vocal and transparent on the matter.

Restricting the regulation of capital flows through trade and investment treaties

Somewhat overlooked in the literature is the fact that by the late 1990s industrialized countries were also effectively restricting the ability of nations to regulate capital flows by signing trade and investment treaties. Most industrialized countries granted each other market access through the General Agreement on Trade in Services (GATS), particularly the Annexes on Financial Services to the GATS, agreed upon in 1997. As later efforts toward multi-lateral trade liberalization have faltered, there has been a proliferation of preferential trade treaties and bi-lateral investment treaties. Many of these implicitly liberalize capital accounts through financial services provisions or explicitly do so through investment provisions.

The United States spearheaded a move to include services in global trade negotiations for the Uruguay Round (1986 to 1992). Because of the strong financial lobby in the US, the United States particularly took the lead role in the liberalization of financial services (Hoekman and Kosecki, 2009). Under the GATS nations can liberalize across four "modes" of financial services. The two most important modes in terms of the capital account are: Mode 1, cross-border supply of financial services; and Mode 3, establishing a commercial presence of financial service providers respectively. At the conclusion of the GATS, IMF analysts found that about 16 countries have significant Mode 1 commitments in financial services, while around 50 each have significant Mode 3 commitments for the

sector – this includes most OECD countries and just a few developing countries (Valckx 2002, Kireyev 2002).

Liberalizing financial services under the GATS or in a preferential trade agreement does not require the wholesale opening of the capital account per say. Sydney Key (2003) says "the bottom line is that if a country makes a commitment to liberalize trade with respect to a particular financial service in the GATS, it is also making a commitment to liberalize most capital movements associated with the trade liberalization commitment. In 2010 the WTO reiterated that liberalizing cross-border trade in financial services (Mode 1) may need an open capital account to facilitate such trade that of course results in international capital flows. A similar scenario can be outlined in terms of Mode 3 liberalization. A loan extended by a foreign bank to a domestic client requiring capital to be transferred from the parent company of the foreign bank to its subsidiary abroad would also require an open capital account (WTO, 2010). The WTO, does have an exception for "prudential measures" taken by states, but it is not clear that such measures include capital account regulations (Hoekman and Kostecki, 2009; Gallagher, 2011).

Regional and bi-lateral treaties, especially those engaging the United States, increasingly restrict the ability of nations to regulate capital flows. The investment provisions of US trade treaties (which are mimicked in US bi-lateral investment treaties) require that all forms of capital "move freely and without delay" among parties to the treaty. Moreover, whereas GATS disputes are settled between nation-states, trade and investment treaties increasingly have "investor-state" dispute settlement that allows a private investor to directly file a claim for damages against a nation that will regulate capital flows. There are no exceptions or safeguards in US treaties, though some treaties do have a "cooling off" period where a private investor has to wait six months or a year before s/he can file a dispute (Gallagher, 2011). This stands in contrast with European, Japanese, or Canadian treaties that provide an exception for the use of capital controls under certain circumstances or carves them out altogether. Indeed, Canada was one of the few nations that did not support amending the IMF's Articles of Agreement precisely because they had safeguarded Chile's ability to deploy regulations under a trade treaty (Chwieroth, 2010).

Table 2 lists the countries that currently have the full policy space to regulate capital flows because they are not members of the OECD, have not liberalized financial services under the World Trade Organizations, and do not have a trade or investment treaty with the United States.

Table 2

Nations with Most Policy Space for Capital Controls*

Afghanistan
Algeria
Angola
Antigua and Barbuda
Bahamas
Barbados
Belarus
Belize
Benin
Bhutan
Bosnia and Herzegovina
Botswana
Brazil
Brunei Darussalam
Burkina Faso
Burundi
Cambodia
Cape Verde
Central African Republic
Chad
China
Colombia**
Comoros
Côte d'Ivoire
Cyprus
Djibouti
Dominica
Equatorial Guinea
Eritrea
Ethiopia
Fiji
Gabon
Ghana
Guinea
Guinea-Bissau
Guyana
Haiti
India
Iran, Islamic Republic of
Iraq
Kenya
Kiribati
Kosovo
Lao People's Democratic Republic
Lebanon
Lesotho
Liberia
Libyan Arab Jamahiriya
Macedonia
Madagascar
Malaysia
Maldives
Mali
Malta
Marshall Islands
Mauritania
Micronesia
Montenegro
Myanmar
Namibia
Nepal
Niger
Pakistan
Palau
Papua New Guinea
Paraguay
Russian Federation
Rwanda
St. Kitts and Nevis
St. Lucia
St. Vincent and the Grenadines
Samoa
San Marino
São Tomé and Príncipe
Saudi Arabia
Serbia
Seychelles
Slovenia
Somalia
Sudan
Suriname
Swaziland
Syrian Arab Republic
Tajikistan
Tanzania
Thailand
Timor-Leste
Togo
Tonga
Turkmenistan
Uganda
Uzbekistan
Vanuatu
Venezuela,
Vietnam
Yemen, Republic of
Zambia
Zimbabwe

**not members of OECD, have not scheduled many GATS commitments in financial services, no US-BIT/FTA*
***FTA pending with US*

Sources:
http://www.imf.org/external/np/sec/memdir/members.htm
http://www.oecd.org/pages/0,3417,en_36734052_36761800_1_1_1_1_1,00.html
http://tcc.export.gov/Trade_Agreements/Bilateral_Investment_Treaties/index.asp
http://www.ustr.gov/trade-agreements/free-trade-agreements

Capital controls and bi-lateral trade treaties became a highly controversial issue in negotiations with Chile and Singapore in the early 2000s. Chile has been well known for its unremunerated reserve requirement whereby a certain percentage of capital inflows need to be deposited in the Central Bank for a minimum period of time. This measure has been econometrically shown to have buffered Chile from the acute crises that struck the region in the 1990s. Singapore saw that Malaysia successfully

deployed controls on outflows in the wake of the Asian financial crisis and wanted to reserve that option. The U.S. adamantly opposed such proposals and both treaties left capital controls actionable—though investors have to wait one year before suing for damages. The Bush administration negotiated similar deals with Peru, Panama, South Korea, and Colombia. The Obama administration maintained the position of the Bush Administration. In response to a letter where more than 250 economists urged the Obama administration to provide flexibility for controls in U.S. trade deals the U.S. replied that they did not intend to change treaties to that effect (Drajem, 2011). Interestingly, the IMF has repeatedly urged trade policy-makers to allow nations temporary derogations from trade and investment treaties to deploy cross-border financial regulations (IMF, 2009, 2012).

The co-existence of cooperative decentralization on the one hand and strong international standards on the other may make it more difficult for nations to effectively cooperate on regulating cross-border finance. For instance, Keynes and White stressed the need to regulate capital on 'both ends.' However, one nation may have the legal freedom to regulate capital under the IMF on one 'end' but a potential cooperative partner may not be able to coordinate on the other 'end' because it may be party to the OECD or a US trade treaty.

The Political Economy of Regulating Capital Flows in the 21st Century

A growing body of scholarship recognizes that financial crises often present opportunities to rethink and change—or at least reinterpret, existing institutions (Blyth, 2002; Schmidt, 2011). The AFC, and even moreso the case of the GFC, were no exceptions. Corresponding to Table 1: US hegemony over global finance became countervailed by the new economic power of emerging market economies (many of whom have deployed controls), interest groups in emerging market economies often supported regulating capital flows and in industrialized countries coalesced around trade and investment treaties to deregulate capital flows. In terms of ideas, an over-bearing weight of econometric evidence began to show that capital account liberalization was not associated with growth and that nations using capital controls were more apt to be stable. Moreover, new developments in economic theory arose that saw cross border finance as inherently instable and articulated a clear rationale for regulation. In terms of institutions, on the one hand the IMF's Articles became open to re-interpretation by nations states, the G-20 and IMF staff and board. Conversely, trade treaties limited the scope and scale of new thinking for many countries. The result is a challenge to the monetary system where on the one hand there is renewed flexibility and impetus for regulating capital flows and on the other hand there is less policy space.

Many significant emerging market countries saw unprecedented growth between the AFC and the GFC. This newfound economic power has balanced the global discussion on regulating cross-border finance. China, India, Brazil, South Africa and other nations are now part of the G-20 (which has played the key role in the crisis rather than the G-8), have (a little) voting power at the IMF and World Bank, and generally have asserted more sway given their market power and dynamism. Many of these nations deploy controls and see them as part of preserving autonomy for domestic objectives. They have been reluctant to liberalize their capital accounts and frequently (or permanently in China's case) deploy capital controls. These countries, to varying degrees could be classified as 'neo-developmental states' or at least a hybrid version of developmental states and neo-liberal approaches that to some degree are trying to 're-embed' markets(Ban, 2012). Many important interest groups in emerging market nations

that saw the threat of export decline due to exchange rate appreciation supported national efforts at capital controls after the GFC (Gallagher, 2012).

Another factor, analogous to past assessments, is the French connection. Dominique Strauss-Kahn used the crisis to reshape the tattered image of the IMF, which had been significantly stigmatized after the Asian financial crisis. Many developing nations accumulated reserves, deployed capital controls, and set up regional financial arrangements in order to avoid the IMF in times of crisis. Projecting a "kinder" IMF was part of Strauss Kahn's objective. Many emerging markets were deploying controls, the IMF wasn't about to pick a fight (Grabel, 2010). Not to be out-done, French President Nicolas Sarkocy also played a key role in reinvigorating the IMF precisely on this issue by charging the Fund to formulate the code of conduct for liberalization and controls.

As was the case in the 1990s, French leadership met with staff enthusiasm at the Fund. A significant turnover occurred at the Fund since the 1990s and many 'big-bang' liberalizers had left, especially in the most leadership positions. Many in the staff used the mandate from Sarkocy, new economic ideas, and the flexibility of the IMF articles to reinterpret or 'incrementalize' its thinking on capital controls (Moschella, 2012). Current and former staff conducted some of the more rigorous econometric analyses showing that capital controls helped stabilize emerging markets in the run up to the GFC and helped mitigate the worst of the GFC's aftermath (Magud et al, 2011; Ostry et al, 2010). Moroever , key staff were influenced by and collaborated with economists (some of them former senior IMF staff) who developed a 'new welfare economics' of capital controls.

Anton Korinek, Olivier Jeanne, and others have developed a new way of thinking about capital flows and capital controls (Jeanne et al, 2012; Korinek, 2011). According to this research, externalities are generated by capital flows because individual investors and borrowers do not know (or ignore) what the effects of their financial decisions will be on the level of financial stability in a particular nation. A better analogy than protectionism would be the case of an individual firm not incorporating its contribution to urban air pollution. Whereas in the case of pollution the polluting firm can accentuate the environmental harm done by its activity, in the case of capital flows a foreign investor might tip a nation into financial difficulties and even a financial crisis. This is a classic market failure argument and calls for what is referred to as a Pigouvian tax that will correct for the market failure and make markets work more efficiently. Alongside these new developments of course, the 'old' economics of capital controls advocated my many Post-Keynesian economists gained new ground because of the lack of credibility that emerged around New Classical Macroeconomics (see Gallagher, 2011).

The United States and interest groups representing the financial sector was ambivalent on one level, and quietly against controls on another. The US (government and financial lobbies)has not obstruct efforts at the G-20 and the IMF but has been quite vocal about not granting its trading partners the flexibility to use controls. The U.S. saw to it that early G-20 communiques called for nations to allow capital to continue to flow freely across borders. However, at the 2011 G-20 summit in Seoul the U.S. endorsed a communiqué that, while not mentioning capital controls explicitly, G-20 leaders called on the IMF and others "to do further work on macro-prudential policy frameworks, including tools to mitigate the impact of excessive capital flows." (G-20, 2010). At the Cannes G-20 meetings in 2011 the US was distracted by the crisis in the Eurozone while Brazil and Germany crafted the 'coherent conclusions' on regulating capital flows discussed earlier. In conversation with senior officials at the U.S. Treasury Department in preparation for this paper, the U.S. "lenience" on this issue at the G-20 marks a shift from the Bush administration and shows that "the door is ajar on capital controls." In February of

2011, US Treasury Secretary was said to have tacitly endorsed Brazil's capital controls when he said that countries such as Brazil may need to adopt carefully designed macroprudential measures to stem inflows." (Winter, 2011).

On the other hand, the US government and the financial sector in many ways moved on from explicit discussion of capital account liberalization at the IMF and have taken it to the WTO and regional and bi-lateral trade treaties. Woll (2010) shows how a variety of firms and governments 'reframed' the globalization of finance into a 'trade in services' discourse that found a new home in trade and investment treaties. The financial services sector was no exception. Especially in the United States, the financial services sector pushed hard in the 1990s and early 2000s to open capital markets through trade treaties (Key, 2003; Kelsey, 2008). In 2010 over 250 economists from across the world urged the US to allow flexibilities so that nations could deploy capital account regulations to prevent and mitigate financial crises. In a letter to the signatories the US stood firm, saying that other measures were more appropriate than cross-border regulations. This stance was echoed by the heads of 17 business lobby groups such as the Financial Services Roundtable, the Business Roundtable, United States Council for International Business, and many others (GDAE, 2011).

V. Summary and Conclusion

This paper traced the history of governing global capital flows and presents a framework for understanding three distinct eras in the modern governance of global capital. The framework emphasizes how power, interests, ideas, and institutions interact to shape each era in different combinations to yield different outcomes. From this perspective, there are many challenges ahead for effectively governing global capital flows.

The Bretton Woods era could be characterized as one of 'cooperative decentralization' where an order was established that allowed individual nations to regulate cross-border finance on their own and informally cooperate as necessary. That regime worked fairly well but a confluence of interest group politics and new economic ideas led to a push to create global regulations to require the full liberalization of capital flows. That project was partially successful at the national level but failed in terms of global governance, with the exception of provisions that limit the ability of nations to regulate capital flows under the WTO and other trade treaties. The current era began with the AFC and has led many nations and actors to rethink the role of regulating financial flows for stability and growth. A shift in economic thinking on capital flows, and the newfound economic power of emerging markets with key interest groups supporting that power, help explain why many nations have return back to regulating capital flows in the wake of these crises. However, the current era is also characterized by the US and lesser extent the EU trying to reassert its hegemony through the limiting of regulatory policy space for capital controls under various trade and investment treaties. What is more, there are some concerns that the new thinking at the IMF may evolve into an amendment to the IMF Articles that will require capital account liberalization but exhibit the more friendly guidelines on regulating capital flows as well.

The result is a patchwork and inconsistent set institutional structures for governing capital flows. Some nations such as Brazil operate under an order of cooperative decentralization where they are

solely bound by the IMF articles of Agreement. Other nations such as Chile have traded away that flexibility to become members of the OECD and party to trade treaties with the United States. This patchwork of institutional structures—and the political forces that support them—may make it more difficult to construct a global system that regulated cross-border finance for stability and growth. The co-existence of cooperative decentralization on the one hand and strong international standards on the other may make it more difficult for nations to effectively cooperate on regulating cross-border finance. For instance, Keynes and White stressed the need to regulate capital on 'both ends.' However, one nation may have the legal freedom to regulate capital under the IMF on one 'end' but a potential cooperative partner may not be able to coordinate on the other 'end' because it may be party to the OECD or a US trade treaty.

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