CHALLENGING THE SOVEREIGN:
INVESTIGATING FINANCIAL GLOBALIZATION'S CHALLENGES TO THE STATE

By

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For Dad, Mom, Cameron and Emily—for your unconditional love and support

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If there ever was a word to describe the 1990s, it would be globalization. This phenomenon has been the subject of political and academic debates and inquiry, but few definitive conclusions about globalization have been reached. Among the many debates surrounding globalization is the debate over the extent to which globalization represents a threat to state sovereignty. The aim of this project has been to investigate this relationship with a particular focus on financial globalization as a challenge to state sovereignty.

Even though it was the initial goal of the researcher to join the chorus proclaiming the end of the sovereign state, the findings presented in this study cannot support that initial perspective. Consequently, I argued that financial globalization has significantly change the pre-1990 conceptualization and practice of state sovereignty but has yet to present a challenge significant enough to completely undermine state sovereignty. The challenges presented by financial globalization emphasized herein include information technology and the internet, non-state actors, speculation, crisis and contagion, and external pressures on domestic decision-making. Each of these challenges are presented highlighting their impact on the domestic and international markets of the United Kingdom. Then, state responses to these challenges both

domestic and global are investigated paying particular attention to the response of the United Kingdom. Britain's domestic responses focus primarily on the restructuring of the Treasury, the Bank of England, and the Financial Services Authority as a means to control technology, non-state actors, and speculation. At the global level, the United Kingdom's participation in the Organization for Economic Cooperation and Development and the European Union are investigated as a means of controlling for contagion and external pressures.

In the end, the empirical evidence of the successful implementation and continuation of these responses to financial globalization suggest that states are able to maintain their sovereignty even in the face of serious challenges presented by financial globalization. While the expression of state sovereignty in these examples was clearly different from previous years, this change in sovereignty does not signal an end or undermining of sovereignty; although, some scholars might see them as the same. Instead, the changes in sovereignty are undertaken as a prerogative of the state—an expression in itself of the state's sovereignty—and do not signal an end to sovereignty. Thus, at this point in time, financial globalization does not represent a fatal threat to state sovereignty.

CHAPTER 1
INTRODUCTION

Globalization was the buzzword of the 1990s and remains today as the 'hot topic' in International Relations (IR) and International Political Economy (IPE). For over a decade, scholars have been exploring the phenomenon of globalization and debating their findings. Globalization literature has focused on a number of different issue areas, including social, political, cultural, and economic globalization. The range of research areas is truly endless under the umbrella of globalization, but for the purposes of this study, our focus will rest solely on financial globalization.

While a seemingly narrow topic, financial globalization is significant to the broader research area of globalization. Within this issue area are a number of elements that are central to the process of globalization as a whole, including technology and non-state actors. Thus, the topic of financial globalization in a sense serves as a micro-level investigation into the broader-picture of globalization. In particular, financial globalization represents an important area of study, because it represents one of the primary issue areas where the debate surrounding globalization's impact state sovereignty has materialized.

Through an effort to understand what globalization is and how it came about, scholars within IR and IPE more specifically have noted that many of the indicators of globalization have presented a challenge to state sovereignty. In particular, the efforts to define financial globalization theoretically and empirically have coincided with a debate over the exact nature of the relationship between financial globalization and state sovereignty. The literature on financial globalization represents the diversity of opinion on this subject ranging from arguments that financial globalization has completely undermined state sovereignty to arguments that globalization has never challenged sovereignty (Strange 1986; Thomson 1995; Barrow 2005).

This project seeks to contribute to this debate by examining further the relationship between the challenges presented by financial globalization and the response offered by states in an effort to retain their sovereignty.

The Research Question

The question of the extent to which financial globalization presents a challenge to state sovereignty serves as the focus of this project. Essentially, this project examines the theoretical literature on financial globalization in order to understand the challenges that the various indicators of financial globalization present to state sovereignty. This project will draw on the body of globalization literature in the subfield of IPE to investigate this relationship.

Globalization literature addresses both the theoretical and empirical aspects of the contemporary world from a number of different approaches. Generally, globalization is seen as an intensification in scope and depth of linkages and interconnectedness between peoples and states that has occurred since the 1960s. Just as the concept of globalization encompasses a number of distinct ‘globalizations,’ there are a number of different theoretical approaches to globalization. In the context of this research project, I will draw primarily on the body of globalization literature that is reflective of mainstream IPE. As such, this investigation assumes the existence of an a priori reality that can be observed with some degree of objectivity. In that observation, states are assumed to be the central actors within the global financial system, even though the presence of non-state actors is recognized and given a great deal of importance. Additionally, the goal of this project is not seeking emancipation from the current global financial system but rather to better understand that system.

It is important to address this issue from a theoretical level for two reasons. First, both the concept of financial globalization and state sovereignty are well-used within the discipline but remain poorly defined. There are a number definitions of both financial globalization and state sovereignty, which often leads to a disconnect in the academic dialogue. Thus, this project will seek to distill conceptualizations of both the concept of financial globalization and state sovereignty. Secondly, by addressing this debate from the theoretical level, it is the aim of this study to lay a foundation for future empirical investigation. While the ultimate focus of this investigation is not meant to be empirical, some empirical examples will be taken from the United Kingdom during the 1990s.

Drawing examples from the British case is particularly relevant to this study because of the centrality of the United Kingdom in the historical and contemporary international financial market. Prior to 1914, Britain enjoyed pre-eminence over the international economic system. This time period, referred to now as *Pax Britannica*, was characterized by British dominance in foreign trade as well as finance with the sterling serving as the primary international medium of exchange (Cassis, 2005: 6). Historically, therefore, London rested comfortably in its position as the world's foremost financial center until this position was interrupted due to the financial strain on the British economy caused by World Wars I and II. Still, in the contemporary context, the United Kingdom had become one of the most 'globalized' economies in the world. In terms of number of foreign banks, foreign exchange trading volume, and number of international companies with a presence in London, the United Kingdom ranks as one of the most global and interconnected financial markets in the world. According to Cassis (2005: 291) London had 481 foreign banks in residence in 2000 compared to only 287 in New York. In 1998, the foreign exchange trading volume in London comprised 32% of the global total whereas the volume in New York rested at 18%. Finally, the London Stock Exchange (LSE) had 499 international companies listed on its exchange in 1999 versus 429 companies on the NASDAQ and 406 on the New York Stock Exchange (NYSE). Moreover, London is unique from other major financial centers in the world, because it ‘specializes in servicing internationally oriented capital flows’ as opposed to only servicing regional markets (Watson, 2002: 197). Finally, the British example is important, because the United Kingdom continues to lead the way toward further financial liberalization throughout Europe and in the rest of the world through participation in the Organization for Economic Cooperation and Development (OECD) and the European Union (EU) (Abdelal, 2006: 6). Given this level of significance to the historical and contemporary international financial market, the United Kingdom represents a state open to the challenges presented by financial globalization. For this reason, the empirical examples provided by this case will prove useful in establishing a theoretical foundation for future empirical investigations into the extent to which financial globalization challenges state sovereignty.

The relationship between financial globalization and state sovereignty has enjoyed a prominent place within the academic and political debates regarding globalization. As a means of contributing to these debates, this project will bring greater clarification to the meanings of financial globalization and state sovereignty as theoretical concepts with added reference to their empirical significance. This clarification is necessary to move forward in both research and policy on the issue of globalization and the ways in which states respond to the various challenges it presents.

Literature Review

Before moving ahead with the research question before us, it is important to first define the two central elements to of study. There is certainly no consensus on the definitions of financial globalization or state sovereignty, but many scholars have weighed in on the debate surrounding the meanings of these two terms. Here, the literature on these concepts will be examined for the purposes of distilling a workable definition of both financial globalization and state sovereignty.

Financial Globalization

Scholars contributing to the literature on financial globalization have defined this concept in a number of ways. With each variation on the definition of financial globalization, scholars propose different ways of looking at state sovereignty. James Tobin (1998: 161) defines financial globalization as the market of 'assets and debts – securities, bank loans and deposits, titles to land, and physical capital'. This market, according to Tobin, was the easiest to globalize, because the communication revolution made the transfer of funds faster and cheaper. Moreover, Tobin (1998: 161) writes that the only barriers to financial transactions are national regulations, and 'as these have been liberalized in country after country, international financial flows have flooded into national securities markets and banking systems all over the world'. However, scholars often propose that 'finance was much more completely internationalized in the nineteenth century' as a way of showing that financial globalization is really nothing new (Tobin, 1998: 162). Then, this historical comparison is often taken to weaken the argument that financial globalization presents any real threat to state sovereignty. Nevertheless, while Tobin refers to the classic argument that financial globalization is itself not entirely new, he recognizes that the speed of these high-volume transactions has led many observers to fear that financial globalization has gone too far too fast. Consequently, in order to regain or retain control over the financial market, governments need to come up with solutions to slow financial transactions as well as to regulate the influx of capital into their states. Tobin's solution is a small tax on foreign transactions, now known as the Tobin Tax, which would prevent rapid transfers of 'hot money' (Tobin, 1998: 167). While states and international organizations have yet to implement such a tax, it is important to note that Tobin believes the speed of financial globalization presents a potentially serious threat to the state.

Dombrowski (1998) offers an important contribution to the debate surrounding financial globalization and state sovereignty. For the purposes of his investigation, the definition of financial globalization is narrowed to 'the system under which credit is created, allocated, and put to use' (Dombrowski, 1998: 2). He then divides the research on financial globalization into three broad categories: global financial structures, regional arrangements, and national financial systems. In each of these areas, Dombrowski sees important implications for the basic theoretical concepts within International Relations, especially the sovereign state. Based on his survey of the literature, Dombrowski concludes that the majority of scholars agree with that 'markets exist under the authority and by permission of the state, and are conducted on whatever terms the state may choose to dictate, or allow' (Strange, 1986: 29 as cited in Dombrowski, 1998: 11). A number of studies have confirmed that states have been critical to the construction and evolution of global finance, but Dombrowski also recognizes that many scholars believe this creation has moved beyond the control of the states. The question of regulation is at the heart of this debate, which has led many scholars to point out the trend toward cooperation between states as well as states and private actors to guarantee levels of regulation. For Dombrowski, this signals not a retreat of the state but a redefinition of the role of the state within the international financial structure (Dombrowski, 1998: 14). He does not believe that collaborative efforts at regulation are a sign of the retreat of the state or a surrendering of sovereignty, but Dombrowski admits that these assertions remain to be tested empirically (Dombrowski, 1998: 21-22).

For Cohen (2001) the central issue of state sovereignty brought into question by financial globalization is not regulation but rather border control. Cohen (2001: 76) writes that the 'significance of globalization is that it is working to disengage the boundaries of the state's authority from its territorial borders, and/or changing the ways in which these boundaries are governed'. For Cohen, state sovereignty is tied to geographic space, which he sees as problematic under the system of globalization. This observation is important to the definition of financial globalization, because it emphasizes the mobility and fluidity inherent in the process. Financial globalization is unique from other periods of financial integration largely because of the breakdown of territoriality. In this way, Cohen's perspective is useful in the debate regarding the integrity of state sovereignty in the face of financial globalization.

Sinclair (2001) and King and Sinclair (2003) present studies of financial globalization that deal primarily with the influence of non-state actors on state sovereignty. Initially, these private actors, banks and ratings agencies in particular, were called on as experts when the global financial structure was being put into place; many state governments handed over the process of financial liberalization and globalization to these private actors. Consequently, these actors have become embedded in the basic architecture of the global financial order (Sinclair, 2001: 441). Presently, this has resulted in private actors setting international rules, institutional operations, as well as systems of self-regulation (King and Sinclair, 2003: 349). What this means for the state is that these private actors have not only established the global financial system but have done so in a way that ensures their unregulated influence. In other words, policy can be made by 'private institutions or networks when the outputs of these private institutions shape the basic norms that produce action in governments and business organizations' (King and Sinclair, 2003: 358). In the current globalized system, this influence has become especially relevant as other non-state actors including pension funds, transnational corporations and private citizens have entered the system. Consequently, this situation presents a real challenge to sovereignty as it deals with the ability of states to establish and enforce rules without external influences. These scholars do not seem totally convinced that states will be able to undo the influence private actors have in the global financial system, but they do believe it will be an important question to address for the future of state influence in the global financial system.

Finally, Hveem (2000) understands the debate between globalization and state sovereignty through the context of regionalization. Regionalization refers to the '*process* that actually builds concrete patterns of transaction within an identified regional space' (Hveem, 2000: 72). Essentially, this is the process where states enter into formal or informal relationships with other states, usually for economic benefit. The foremost example of regionalization in the contemporary era has been the European Union (EU), but other examples include the North American Free Trade Agreement (NAFTA) and the Association of Southeast Asian Nations (ASEAN). Clearly, some of these regional organizations are more deeply integrated than others, but they all represent the movement by states toward deeper inter-state economic and political relationships with other states in close geographic proximity. Hveem writes that among scholars of globalization, the process of regionalization is seen 'as part of the effort of states to cope with a pervasive globalization, and they see the region as a staging post for corporate actors on their way to becoming global participants' (Hveem, 2000: 70). This has been particularly relevant for financial globalization as regional agreements have often helped to contribute to state and private firm competitiveness as well as their protection against the volatility of the financial system (Hveem, 2000: 78). In this case, Hveem argues that the region has become important to the process of globalization, because regionalization represents an effort by states to seek authority and global governance that is lacking in the current global system (Hveem, 2000: 77). Here, Hveem brings the process of regionalization into the conceptualization of globalization as a central component of this process.

Clearly, the concept of financial globalization has taken on a number of definitions throughout the academic literature. For the majority of the scholars reviewed here, the definition of financial globalization is quite narrow usually only emphasizing one or two indicators. The goal in this project, however, is to integrate these specific indicators into a broader and workable conceptualization of financial globalization, which will be presented below.

State Sovereignty

Also important to this debate are the scholars whose primary focus is state sovereignty. Krasner (2001a and 2001b) is an example of one scholar who contributes to this debate from the sovereignty-focused approach. He argues that 'sovereign states are the building blocks, the basic actors, for the modern state system' (Krasner, 2001b: 230). Consequently, sovereignty has been defined in a number of ways, and Krasner cites four primary dimensions of sovereignty. First, sovereignty can be understood as the ability of the state to control movement across its borders. This aspect of sovereignty is commonly expressed through controls on trade and immigration. Secondly, sovereignty can be defined by the authority structures within states and the ability of these structures to effectively regulate domestic behavior. Here, sovereignty rests with the institutions and domestic structures of government. As such, domestic sovereignty encompasses both the acceptance of these authority structures and the degree of control that the state can actually exercise on its citizens through these structures. Krasner defines the third component of sovereignty as Westphalian or Vattelian sovereignty which speaks to the ability of the state to exclude external sources of authority in the decision-making process. Essentially, this aspect of sovereignty focuses on the ability of the state to devise foreign policy free of external pressures. Finally, international legal sovereignty comprises the mutual recognition of states. This facet of sovereignty rests on the state being an independent territorial entity that is capable of entering into voluntary contractual agreements with other states (Krasner, 2001b: 230-233). Based upon his definitions of sovereignty, Krasner argues that globalization does not represent a significant threat to state sovereignty. With respect to financial globalization, Krasner writes that 'high capital flows and the rules of sovereignty have coexisted for at least two centuries even though this environment can be problematic for domestic sovereignty as well as sovereign control over cross-border movements (Krasner, 2001b: 235). Krasner is ultimately unwilling to part with his four-part conceptualization of sovereignty, but he does concede that globalization, especially monetary and financial globalization, is changing the scope of state control. This is particularly evident in the willingness of states to walk away from issues they can't resolve, which ultimately causes states to turn over control in these issue-areas to other actors (Krasner, 2001a: 24). Ultimately, Krasner never fully expands these thoughts in part because of his fundamental belief in the staying power of state sovereignty.

Wang (2004) is not entirely convinced that the concept of state sovereignty is without contestation. He defines sovereignty as 'absolute supremacy over internal affairs within its territory, absolute rights to govern its people, and freedom from any external interference in the above matters' (Wang, 2004: 473). With regard to globalization, Wang believes that sovereign states are substantially restrained even though it might have been of their own doing (Wang, 2004: 483). States may still be free to choose their own internal policies, but Wang is doubtful that states are still free from external interferences. Ultimately, Wang doesn't believe that states have a choice in their internal affairs, because they must live with the constraints put in place by the forces of globalization (Wang, 2004: 481). Consequently, based on Wang's definition of state sovereignty, it is easy to see the importance of examining the external pressures brought upon the state because of globalization. Nevertheless, Wang's conclusion draws primarily on a study of the World Trade Organization (WTO) and thus remains to be applied to the area of financial globalization.

Just as is the case with the definition of financial globalization, the concept of state sovereignty has taken on a number of meanings throughout the literature. In this case, it is also important to narrow and refine the concept of state sovereignty, which will be undertaken in the following section.

Conceptualizations

Defining financial globalization is not an easy task as the literature on globalization represents a range of perspectives on the topic. In an effort to present a comprehensive definition of financial globalization, the literature has suggested the following elements as necessary components of the definition

- markets of currencies, assets, loans, derivatives, and credit;
- proliferation of communication technology, especially the internet, as the forum for this market;
- inclusion of non-state actors in the market;
- financial liberalization and deregulation, particularly with regard to border control;
- regional integration.

Thus, for the purposes of this project, I define financial globalization as: the increasingly digital market where currencies, assets, loans, derivatives, and credit are traded by state and non-state firms across deregulated borders.

As a secondary component to this definition, the spread of financial globalization has coincided with increased levels of regional integration that primarily serve as a way for states to control for the potential adverse affects of globalization. Thus, the process of financial globalization is not simply about bringing the domestic financial markets into one international market, but it is also about creating new regional markets that are subsumed under the international market. Here, regional integration must be viewed an answer to the question ‘what is financial globalization’ as opposed to an answer to the question ‘what indicators of financial globalization challenge state sovereignty’. This brings to light an important nuance in this discussion—the definition of financial globalization includes both its challenges to the state as well as states’ response to these challenges.

Just as is the case for the definition of financial globalization, the definition of state sovereignty must be consolidated for the purposes of this research project. Here, the concept of state sovereignty will be based on Krasner’s four components of sovereignty, which include

- the ability to control movement of financial goods and services across state borders;
- the ability to regulate domestic financial activity through legislation and institutions;
- the ability to exclude external pressures from the domestic decision-making process on financial regulation and enforcement of that regulation;
- the ability to enter voluntarily into binding agreements between other nation-states and non-state financial firms, which includes the ability to join regional or international organizations and willingly submit to their governance measures.

This is by no means an exhaustive list of the components that can go into a definition of state sovereignty, but it will hopefully provide a level of clarity and parsimony in the process of empirical investigation.

Conclusion

As previously stated, the purpose of this study is to examine theoretically the ways in which financial globalization represents a challenge to state sovereignty. In so doing, this research will draw on the globalization literature as well as empirical examples from the British experience with financial globalization from the 1990s to the present day. The globalization literature suggests that the indicators of financial globalization represent formidable challenges to state sovereignty. It is clear from both an examination of the literature and the empirical example of the United Kingdom that financial globalization is a reality and one that states must engage. Still, while financial globalization has changed the international context within which states exist, this project cannot not argue that the challenges of financial globalization have completely undermined state sovereignty.

Even though it was the initial goal of the researcher to join the chorus proclaiming the end of the sovereign state, the findings presented here cannot support that initial perspective. Consequently, I argue that financial globalization has significantly changed the pre-1990 conceptualization and practice of state sovereignty but has yet to present a challenge significant enough to completely undermine state sovereignty. Here, change is not seen as signaling an end or undermining of sovereignty, although some scholars might see them as the same. Instead, the change of sovereignty is seen as a prerogative of the state—an expression in itself of the state's sovereignty—rather than an end to sovereignty. Thus, at this point in time, financial globalization does not represent a fatal threat to state sovereignty.

CHAPTER 2
GLOBALIZATION'S CHALLENGES TO STATE SOVEREIGNTY

It has been argued by a number of scholars that the current international system under globalization undermines state sovereignty. In general terms, the factors responsible for the evolution of globalization are seen as simultaneously presenting a number of challenges to the state's retention of its domestic and international sovereignty. Among the most influential of these scholars is Susan Strange, and her work on the challenges of globalization for the sovereign state has served as the foundation for the rest of this literature within the field of IPE. In *Casino Capitalism*, Strange makes a statement that has come to shape the subsequent literature on this issue:

> Political leaders, and their opponents, like to pretend that they are still in control of their national economies, that their policies have the power to relieve unemployment, revive economic growth, restore prosperity and encourage investment in the future. But recent years have shown again and again how the politicians' plans have been upset by changes that they could not have foreseen in the world outside the state. (Strange, 1986: 3)

What Strange could not have known in 1986 was that the 'world outside the state' that was beginning to emerge during the 1980s came to fruition in the 1990s under what is now termed globalization. Her observations were simply the beginning of the lively dialogue concerning the challenges of financial globalization to state sovereignty.

Here, the claim that financial globalization challenges state sovereignty will be further explored and analyzed in light of the theoretical discourse as well as the empirical example provided by the United Kingdom during the 1990s. Through this analysis, it will be argued that while financial globalization does challenge the retention of state sovereignty in some respects it also opens new avenues for the maintenance of state sovereignty. Essentially, the relationship between financial globalization and state sovereignty is not as deterministic as the literature suggests—meaning financial globalization does not necessarily lead to the loss of sovereignty.

Instead, financial globalization has caused the international context to change thereby forcing states to express sovereignty in different ways.

Many of the indicators of financial globalization also represent the most formidable challenges that financial globalization presents to state sovereignty. This analysis focuses on five indicators of financial globalization that are commonly cited as the most difficult challenges for states to overcome in their efforts to maintain their sovereign status. These challenges are (1) technology and the internet, (2) non-state actors, (3) speculation, (4) crisis and contagion, and (5) external pressures.

Information Technology and the Internet

Studies of information technology and the internet have certainly taken center stage in the globalization literature. The ‘digital revolution’ in the early 1980s caused a sensation in the international markets as well as in academic literature. States and markets all over the world embraced technology as an integral component of political, social, and economic life. Moreover, technology has spread rapidly throughout the world with global estimates of internet users jumping from 16 million in 1995 to over 580 million in 2002 (Khiabany, 2003: 143).

For many scholars, the proliferation of information technology exemplifies the beginning of the process of globalization (McMahon, 2004). The internet and corresponding technologies have proven central to the evolution of globalization throughout the last ten years. In fact, scholars argue that ‘many of the changes that have been observed in the operations of global financial markets have been ascribed to the world’s rapidly evolving technological capabilities’ (Dombrowski, 1998: 3). While creating numerous changes in the global financial market, increases in information technology and the internet have also challenged the sovereignty of the state. As a component of financial globalization, information technology has challenged state sovereignty through the increased speed and volume of financial transactions, feasibility of establishing offshore trading locations, and the creation of e-currency as a vehicle currency.

This technology, and especially the internet, has in effect created a new marketplace for the global financial market. Prior to the 1980s, financial transactions often required paper documentation that had to be reviewed by various divisions in corporations or the government and approved prior to the completion of the transaction (Cohan, 2006). This process was slow and very complicated, but the introduction of information technology changed all of this. The emergence of computer technology, especially personal computers (PCs), allowed for improved data processing, information sharing, and market mobility. In addition, the new computer technology came with software that also improved the efficiency of business, such as Microsoft Excel's spreadsheets and other business intelligence (BI) programs. These BI programs 'enable analysts to pinpoint business opportunities by analyzing huge volumes of transactional data'; the volume of this data can range depending on the specific program, but in general it can process in the 10s of millions of transactions (Cohan, 2006: 21). Consequently, for firms in the financial market, this has opened up the opportunity to conduct business in a number of different commodities and in a number of different domestic markets since their technology has the capability of processing these large volumes of data. Finally, technological advances in buying and selling have made the market instantaneous (Katada, 1997: 78). This is especially due to the creation of electronic funds transfer (EFT) technology that allowed transactions to be process and paid for instantaneously over the internet (McMahon, 2004: 74). Almost instantly, financial markets all over the world became available 24-hours a day thereby increasing the speed and efficiency of the market. Moreover, the proliferation of the internet as a way to link these 24-hour markets transformed the market itself.

Online transactions opened wide the barriers previously imposed by geography. Before the proliferation of online technology, the process of conducting a financial transaction took place in a room, in a building, in a city, in a state bound by the rules and regulations of a government. Now, while the major financial centers of the world, including London, continue to be major financial centers, 'cyberspace' has completely redefined the geography of the international financial markets. Firms can now conduct business essentially anywhere that they can connect to a form of electronic communication, whether it be phone, fax, or the internet; and because of satellite technology, this means firms can set up business virtually anywhere in the world (Yeung, 1998: 294). In the case of some UK banks, Davies (1997: 219) writes that 'the management of their global foreign exchange book will be in London during London office hours, then it will switch to the US operation … after the United States close it will move again, to the Far East'. Thus, the financial market has become mobile in a way that was previously never seen.

As a further example of the result of the advances in information technology, financial transactions are increasingly taking place in what is commonly known as 'offshore locations' (Leblang, 1997: 436). Offshore financial centers (OFCs) are small islands located all over the world that house financial firms who participate in international financial markets by way of the internet technology (Cobb, 2001: 161). Among the most important of these OFCs is the Isle of Man, located in the Irish sea, which serves as a tax haven for European, and especially British, financial firms. The Isle of Man has an estimated population of only 75,000 but a 'GDP of £801 million and an offshore banking deposit base of almost £23 billion' thereby making it an important location for financial transactions (Cobb, 2001: 166). It is estimated that as much as half of the world's currency either resides in or passes through these OFCs, and as such, these locations have become a cornerstone of the global financial market (Cobb, 2001: 163).

These locations have re-defined the physical geography of the financial market as well as its regulation. The ability to avoid the historical geo-physical constraints of the market, especially in using the internet as a trading forum, has challenged the stability of domestic border controls and market regulations. The internet has allowed firms to participate in domestic markets without having to physically cross the border of a state thereby avoiding the traditional understanding of 'border' control. Therefore, previous measures of control such as customs or requiring registration with the local government are no longer applicable in a highly mobile market (Cobb, 2001). Thus, in order for the state to continue to have control over its domestic financial market, it must establish new ways of regulating transactions that occur via the internet and thus reach into offshore locations.

Finally, information technologies have paved the way for the use of electronic money in a number of economic sectors but especially within the financial market. In the international arena, the use of electronic money makes currency conversion virtually unnecessary and capital mobility increasingly seamless (Helleiner, 1998: 388). According to Helleiner (1998), nearly all of the international financial transactions are conducted using electronic money as opposed to paper or currency. The primary challenge electronic money presents to state sovereignty is its use in making monetary and financial crime easier. International money laundering through financial transactions, fraud, and drugs/arms trafficking have all become concerns for states (Helleiner, 1998 and Dombrowski, 1998). Spalek (2001: 75) writes that financial crime in Great Britain has become a common part of the financial system. Electronic money is a challenge to state sovereignty, because it lacks the potential for regulation that paper money has; it is more difficult to tell if electronic money is counterfeit or to track its movement across physical space. Here again, the technological dimension of financial globalization presents challenges to states' control over financial markets and thus to their sovereignty.

In summary, information technology as an integral component of financial globalization presents a challenge to the state's ability to regulate domestic financial activity. Due to the use of the internet, buyers and sellers are no longer obligated to pass through physical state borders to reach the location of financial trading, nor are they required to remain in one physical location under the rules of that particular state (Helleiner, 1998: 389). In the example of the United Kingdom, technology has enabled offshore firms to participate in the domestic financial market without actually residing in London; consequently, regulating the domestic market requires additional measures beyond federal legislation since a firm may establish its physical location outside the jurisdiction of that legislation. Moreover, the speed of transaction has required that states invest additional time and money into technological advances and training of personnel to continually monitor the markets, which proves to be quite costly (Bank of England, 1997: 109-110). Finally, electronic money presents a completely new challenge for state regulation over monetary and financial crime as these activities have been made easier by advances in technology. Here, sovereignty understood as the ability to regulate domestic markets is clearly challenged by the information technology present in the phenomenon of financial globalization.

Non-state Financial Firms

The challenges presented to state sovereignty through information technology are also tied to the challenges presented by non-state financial firms. As another component of financial globalization, the evidence of non-state firms in the global market is directly connected to the increased proliferation of information technology.

Prior to the advent of the internet, buying and selling on the financial markets were primarily restricted to state governments and a few financial firms in the major metropolitan centers (Cassis, 2005). Now, the availability of cyberspace and the boom of personal computers have opened the market to private firms or individuals who may have been prevented access to the market prior to the 1990s (Yaziji, 2004; Sinclair, 2001). These new non-state actors have included pension funds, insurance firms, private citizens and transnational corporations. In fact, many of the non-state actors now participating in the financial market do not conduct their primary business within the financial sector; the instance of firms crossing over from other sectors into the financial market has risen at an exponential rate in the last decade. De Goede (2004: 198) writes that the involvement of such corporations as Enron and General Motors in the international financial market makes it difficult for states to regulate financial trade since the majority of their corporate activity is regulated in other sectors. The quantity and type of non-state actors involved in the financial system is astounding and a just discussion of this issue is beyond the scope of this project. Still, these non-state actors are critical to the discussion of financial globalization's challenge to state sovereignty.

The state's ability to regulate domestic financial activity through legislation and institutions is an important component of the definition of state sovereignty, which the presence of non-state actors complicates. In order to regulate financial activity, a state must have the ability to oversee the participants in the financial market through a relationship of legislation and enforcement. Previously, these relationships were fairly straightforward as they involved a small number of large banks and other states, but today the relationship of regulation and enforcement has been expanded to encompass states, private corporations, banks, and individual citizens. As such, the principles of inter-state diplomacy do not apply to non-state actors, and consequently, states must become more inventive to stay abreast of the financial activities of these consumers. In addition, the issue of regulating financial transactions is further complicated; it is much easier to track the activity of a slow-moving government bureaucracy or national bank but much more difficult to keep track of multiple participants, especially private citizens (Watson, 2002: 205). Finally, the relative wealth of many of these non-state actors has given them an amount of power over the workings of the financial markets, what Cohen (1998: 133) describes as a 'de facto veto power, elusive but effective, over state behavior' in the area of financial regulation. In these ways, the involvement of non-state actors in the financial markets represents an important challenge to state sovereignty.

In addition, the presence of non-state actors within the financial market has contributed to the creation of a 'casino' of sorts (Strange, 1986). Many of these non-state actors are heavily involved in complex derivatives trading that involves high levels of risk, since they have other sectors from which to make a profit. For example, trading in weather derivatives has become a very popular market; since there are a number of businesses whose profits depend on the weather, there is a lot of money to be gained through betting on these businesses (De Goede, 2004). However, these markets tend to be very complex and dynamic making it costly in terms of technology and personnel for states to constantly regulate this type of activity (Li and Smith, 2002: 776). Clearly, the participation of non-state actors in the financial market is a serious challenge to state control over the volatility of the market, and in this way, financial globalization presents another real and potential challenge to state sovereignty.

Speculation

This speed of business has also opened the door for another critical challenge presented to the state from the global financial market, which is speculation. Speculation is nothing new to financial markets, but the speculation that exists in the global financial market is on a much larger scale and happens at a much faster pace than in periods prior due largely to advances in technology.

Speculation refers to the practice of buying and selling in expectation of a gain from fluctuations in the market. As such, speculation usually involves taking some amount of risk to seek profit. This process has been equated with gambling in a casino where ‘sheer luck begins to take over and to determine more and more of what happens to people’ (Strange, 1986: 2). Presently, short-term financial transactions are the primary vehicle by which firms speculate on fluctuations in currency, interest rates, and even such things as weather forecasts or public opinion polls (De Goede, 2004: 198).

The dangers of speculation are commonly understood to represent a formidable challenge to the state. Speculation depends on market volatility, which is something states work hard to avoid (Kirshner, 1995: 29). For speculators, however, high levels of volatility signal high levels of potential profit. For a state, however, this quest for profit often involves high levels of risk which can further complicate their efforts to control volatility and stabilize the market (Kirshner, 1995: 12). The experience of the United Kingdom during 1992 serves as a poignant example of the challenge speculation brings to state sovereignty.

The effects of speculation came full force to the British financial market on Wednesday, 16 September 1992. This date, known as Black Wednesday, marked the forced exit of the British pound from the European Monetary System’s exchange rate mechanism (ERM). The ERM was a tool used to encourage currencies throughout Europe to come as close as possible to the exchange rate of the German Deutschemark (DM) in preparation for further economic integration (Cobham, 1997b: 1128). The United Kingdom, in seeking a solution to controlling inflation, joined the ERM in October 1990 (Cobham, 1997b: 1129).

Soderlind (2000: 8) writes that the possibilities for a Black Wednesday crisis were not far removed during 1992 because 'the tight German monetary policy after the reunification resulted in high interest rates and appreciation of the ERM currencies against the US dollar'. In the United Kingdom, the high interest rates proved particularly problematic to justify given the slow growth and low inflation, which would normally demand low interest rates (Soderlind, 2000: 8). While the possibility for a crisis in the ERM had been evident since earlier in the summer of 1992, it is suggested that speculation over the devaluation of the pound forced the cost of defending the price of the pound to become too high for the British government (Masson, 1995: 580). The pound was in fact suspended from the ERM on Black Wednesday and depreciated the following day by more than 5% against the DM (Soderlind, 2000: 10-11). Speculators, such as the famed George Soros, anticipated the devaluation of the British pound and capitalized on the opportunity. Pounds were borrowed and sold for DM at the exchange rate prescribed by the ERM; thus, when the pound was finally devalued, the loans could be paid back using this devalued currency and speculators would pocket the difference. In the end, only estimates regarding the total amount lost by the UK government have been reported, but those estimates total around US$4.91billion (Masson, 1995).

According to the British Treasury, while 'speculative forces' were not the 'fundamental cause' of withdrawing from the ERM, they were important in setting off 'the trigger for the collapse' (Treasury, 1992: 2). Thus, the challenge of speculation must be understood not as a danger in and of itself but rather as an element that can exacerbate already volatile market conditions. In the case of Black Wednesday, the withdrawal from the ERM seemed to be looming for months, but the speculative attacks made loss of revenue and credibility higher and more significant over the long-term (Masson, 1995: 571). In fact, this loss of credibility after the speculative attacks may have contributed to the overall dissatisfaction with the Conservative government under Prime Minister (PM) John Major and to the election of New Labour under PM Tony Blair in 1997 (Cobham, 1997b). Here, it is clear that the adverse effects of financial speculation left their impression on the UK.

Given this example, it is clear that speculation has come to represent a serious challenge to state sovereignty under the system of financial globalization. As such, states must develop new measures for controlling market volatility and short-term transactions that provide the fertile context for speculation. Thus, the states' ability to regulate domestic financial and currency markets as a component of its broader sovereign status is called into question by speculation.

Crisis and Contagion

In addition to creating an environment hospitable toward non-state actors and speculation, the spread of information technology as a component of the globalized financial system has been responsible for the further integration of domestic financial markets. Even prior to the 1980s, it was recognized that the domestic financial markets were connected in a phenomenon that was then referred to as interdependence (Keohane and Nye, 2000). Interdependence 'refers to situations characterized by reciprocal effects among countries or among actors in different countries' (Keohane and Nye, 2000: 105). Today, however, the process of globalization has taken this interdependence to the next level. Essentially, technology has worked to further 'shrink' the distance between domestic financial markets thereby deepening the already established patterns of interconnectedness (Mattli, 1999: 77 and De La Dehesa, 2006: 5). According to Keohane and Nye (2000: 105), the old system of interdependence is different from the contemporary context of globalization, because of the multiple linkages that exist between countries (as opposed to single linkages) and because these networks span multicontinental distances. While advocates of globalization see many positive results of this progression, there has been a serious negative consequence, which is the likelihood for crises and contagion.

According to scholars, ‘rapid changes occurring in the international financial system have resulted in new sources of, and transmission mechanisms for, systemic shocks’ (Heimann and Lord Alexander, 1997: 82). Systemic shocks, which prior to financial globalization could have been contained within domestic or regional markets, are much more difficult to contain when a multitude of the domestic financial markets around the world are connected through technology. This has created a system beset with systemic risk, which is ‘the risk that something which goes wrong in one firm or market will, because of linkages which now exist between firms and markets, spill over to affect other firms and markets’ (Bank of England, 1998: 4). This ‘spill over’ is also known as contagion and refers to the transmission of volatility, crisis, or shocks from one market to another. In the 1990s, the danger of contagion became a reality in the East Asian Crisis.

In 1997, the newly-industrializing countries in Asia experienced a devastating financial crisis of the currency and stock markets that resonated throughout the world. The crisis was largely the result of the quick exit of capital inflows and currency speculation, which had been characteristic of the majority of the economies in Southeast Asia, especially Thailand and Korea (Lukauskas and Minushkin, 2000: 701). Essentially, the East Asian Crisis had three components:

> (1) a *currency crisis*, a rapid outflow of financial capital in anticipation of a possible currency depreciation, inducing depletion of reserves, and forcing a radical change of policy – in this case abandonment of fixed exchange rates in favour of floating rates during a period of loss of confidence; (2) a *financial crisis*, a collapse of domestic financial institutions induced by the currency depreciations and high domestic interest rates, which resulted from the currency floats; and (3) an *economic crisis*, a contraction of output causing a loss of government revenue, loss of employment and consequent loss of

> household incomes, producing serious hardship for large numbers of people. (Warr, 2003: 381-382)

The effects of the economic disturbances in these countries were felt throughout the world and were evident in ‘bank failures, corporate bankruptcies, stock market turbulence, depletion of foreign exchange reserves, currency depreciation and increased fiscal burden’ (Das, 2003: 19). The effects of the East Asian crisis signaled the reality of contagion for the global system; contagion refers to the spread of shocks or other economic disturbances from one state or market to another (Das, 2003). Here, the crisis felt in Southeast Asia quickly became a problem for the entire world, largely as a result of the interdependence and integration of domestic markets into a global system of markets.

The implications of the 1997 crisis are critical to the study of globalization in the years after. The contagion of the crisis throughout Asia and the rest of the world suggests that the interconnectedness so often associated with globalization is a reality and one that spreads across both geography and relative wealth of an economy. Moreover, the events of 1997 reveal that the contemporary system of globalization has made the reality of crises and contagion even more severe than in years past, largely because of the deep level of interdependence. For example, Keohane and Nye (2000:112) write that ‘whereas the debt crisis of the 1980s was a slow-motion train wreck that took place over a period of years, the Asian meltdown struck immediately and spread over a period of months’. As such, the potential for widespread financial crises is a serious challenge facing the global financial market, especially those states that are deeply embedded in the system such as the United Kingdom.

The realities of financial crises and global contagion represent a new challenge to the traditional perspectives of state sovereignty. In the case of the East Asian Crisis, intervention in the domestic financial markets in Thailand and other states would have been a violation of their sovereignty. However, the failure to intervene resulted in a loss of other states' abilities to control their own domestic markets. Thus, under the system of financial globalization, states must redefine sovereignty and its expression relative to other states so as to include measures to regulate both domestic financial activity and international financial activity. In this way, the experience of crises and contagion as an element of financial globalization challenges state sovereignty.

External Pressures

State control is also limited by the external pressure to liberalize from other states and inter-governmental organizations in the international system. This pressure has been existent since the early days of financial liberalization. Following the tragedy of World War II, which many believed was caused by financial crises, the victorious states set out to create an economic system that would link domestic economies and prevent future economic instability (McMahon, 2004: 74). The primary route for accomplishing this goal was to liberalize the financial markets of domestic economies.

At its core, financial liberalization refers to the removal of capital controls on the inward and outward flow of financial assets. In other words, liberalization is the process of de-regulating the financial system (Svensson et al., 2006:47). During the Bretton Woods era, it was argued that financial liberalization was an optimal method for ensuring the interconnectedness of the international economic community to encourage people, assets, goods, and services to flow more freely from one state to another (Yeung, 1999: 291). Consequently, financial liberalization came to serve as a prerequisite for entering into this agreement as well as the international market at large; states experienced pressure to liberalize as a sign of modernity and development by the United States and other international organizations such as the World Bank (WB) and the International Monetary Fund (IMF). However, the consequences of financial liberalization were not always positive for domestic markets or the retention of state autonomy over decisions relating to these markets (Mosley, 2000: 738).

Today, this early process of financial liberalization is typically understood to be the building blocks of financial globalization (Stulz, 2005: 1595). However, scholars suggest that these external pressures have dramatically increased since the early 1990s. According to Lukauskas and Minushkin (2000: 697), ‘the United States and several international organizations, notably, the International Monetary Fund (IMF), stepped up their demands on countries to liberalize their financial systems’. In many ways, this pressure is the direct result of US interests and has been successful because of the hegemonic position of the United States in the world economy (Gilpin, 2000; Helleiner 1994). Even in the case of international organizations, many scholars and opponents of globalization see the policies of these organizations as serving the interests of the United States rather than the global financial system at large. These charges are quite serious, because if true, they imply that as states agree to the policies enacted by these organizations they are simultaneously handing over their ability to make decisions on their domestic markets without external pressures. For those states refusing to succumb to these external pressures, the costs of this defiance are becoming increasingly difficult to bear (Li and Smith, 2002: 776). These costs have included the inability to receive aid from such organizations as the IMF and the World Bank, the inability to trade with other states, and the inability to have a voice in international organizations who dictate policy for the majority of the states in the world. Consequently, many states are currently engaged in the struggle to maintain their independence in decision-making while simultaneously receiving the benefits of agreeing to financial liberalization pressures. Thus, the external pressures to liberalize represent an important challenge to state sovereignty.

Conclusion

A myriad of the challenges presented by financial globalization to the state have been discussed here. Technology, non-state firms, speculation, crisis and contagion, and external pressures are all evident in the expansion of financial globalization and all represent unique challenges to the state. In the next chapter, we will examine the ways in which the state has or has not responded to these challenges in order to determine the extent to which financial globalization is a threat to state sovereignty.

CHAPTER 3
THE STATE RESPONSE TO FINANCIAL GLOBALIZATION

In the face of the challenges presented by financial globalization, we now turn to the question of how the state responds to financial globalization in an effort to retain its sovereignty. As the starting point for this discussion, we turn first to an examination of the role of the state in the early years of financial globalization. Understanding the initial role of the state in this phenomenon is critical to understanding where the state currently stands in relation to globalization today.

It is a widely held assumption in the globalization literature that the state is the primary author of the globalized financial system (Strange, 1986; Helleiner, 1994; Leblang, 1997; Stulz, 2006). From its earliest beginnings as financial liberalization expressed primarily through the Bretton Woods agreement, states were responsible for establishing the building blocks of financial globalization (Yeung, 1998: 296). The Allied states led by the United States were responsible for re-constructing the international financial system and did so in a way that facilitated the growth of financial globalization. Due to the initial control states had over the beginnings of financial globalization, some scholars argue that 'we must not exaggerate the extent of financial globalization' (Leblang, 1997: 451). Here the assumption reads that initial control determines perpetual control, even though the international context in the 1990s had changed dramatically since the 1950s.

Thus, this conventional assumption is rejected in this project. It has already been established that the challenges presented by financial globalization have undergone a significant change largely due to the technological revolution in the 1980s. Consequently, this project aims to examine anew the relationship between the state and the global financial system. Nevertheless, the historical role of the state remains important as it sets the context for the contemporary state response; states today react to the challenges of financial globalization based upon the history of this relationship. In addition, the contemporary response to globalization as an issue of sovereignty must be judged in contrast to earlier expressions of sovereignty; in order to know what has been lost or retained, we must assume that sovereignty was existent in the first place. Thus, for the purposes of this project, we adhere to the assumption that states were responsible for creating the international context of financial globalization while retaining each of the four elements of sovereignty as expressed in the initial conceptualization of the term. It is important to clarify here that the states we speak of in the context of financial globalization are 'very large states: the great and near-great powers' as opposed to all of the states in the world, many of whom continually struggle with sovereignty (Kirshner, 1995: 23). Thus, in moving beyond the historical context of state sovereignty, we turn to the primary subject of this discussion which is how states respond to the challenges of financial globalization.

State response to financial globalization generally falls under one of two approaches: either breadth or depth. When a state chooses to respond to financial globalization from the breadth approach, it chooses a comprehensive or 'big-picture' strategy. This usually entails regulating the market and participating firms at large, as opposed to on a specialized level (Lukauskas and Minushkin, 2000: 698). Typically, institutions or broad-based legislation serve as the source of control in this approach. On the other hand, in approaching the response from a depth approach, the state will enact market regulations that apply more specifically to individual firms or commodities. This might mean that restrictions are placed on stocks or bonds but not on loans or pension funds; in a similar way, states might chose to monitor the market activity of banks but not the activity of private citizens (Lukauskas and Minushkin, 2000: 699). It is important to note that neither of these approaches are exclusive as a state may chose broader controls over-all while specifically targeting one type of firm or commodity that is particularly troublesome.

In using the example of the United Kingdom, this investigation will examine the state response to financial globalization from an approach that emphasizes breadth. As is the case with many of the wealthiest countries in the world, the United Kingdom has chosen to respond to financial globalization as a wider phenomenon instead of focusing on the individual challenges. While some scholars would seek to deny financial globalization as a comprehensive phenomenon, the governments of these states have embraced this conceptualization of financial globalization and have responded to it as such.

Dearlove (2000: 114) reminds us that 'ideas continue to matter in politics'. As such, we can observe that

> whether accurate or otherwise it is the ideas political subjects hold about the context in which they find themselves rather than the material reality of the context itself that informs their conduct. Consequently, … whether the globalization thesis is 'true' or not may matter far less than whether it is deemed to be true (or, quite possibly, just useful) by those employing it. (Hay, 2001: 234)

What this quote from Hay suggests is that the discourse about whether or not globalization is a true phenomenon means very little if politicians claim the concept as true through their discourse. In the case of Great Britain, this is particularly important.

We can decipher from the economic policies enacted by the British government that globalization has been considered more significant than just a rhetorical concept for the states facing the challenges of financial globalization. Indeed, the British government has taken these issues seriously and has responded in a manner that aims to retain state sovereignty over the domestic and global financial market. In examining the breadth of this response, our investigation will look first at the domestic-level response and then at the global-level response. At the domestic level, reforms have been made to the Treasury, the Bank of England (BoE) and the Financial Services Authority (FSA) in an effort to retain sovereignty, especially in light of the challenges presented by technology, non-state actors, and speculation. Here, the two elements of sovereignty that are specifically addressed are (1) the ability to control movement of financial goods and services across state borders and (2) the ability to regulate domestic financial activity through legislation and institutions. At the global level, the British government sought out international cooperation with the Organization for Economic Cooperation and Development (OECD) and the European Union (EU) as a way to respond particularly to the challenges of contagion and crises as well as external pressures on the decision-making process. At this level, the response to financial globalization addresses the final two components of sovereignty: (1) the ability to exclude external pressures from the domestic decision-making process on financial regulation and enforcement of that regulation and (2) the ability to enter voluntarily into binding agreements between other nation-states and non-state financial firms, which includes the ability to join regional or international organizations and willingly submit to their governance measures. Thus, the success of these responses by the United Kingdom to financial globalization will be evaluated as an illustration of the extent to which state sovereignty can withstand the challenges of financial globalization.

Domestic Response

The British government made responding to the domestic effects of financial globalization a priority after the Black Wednesday Crisis in 1992. After this event, the government under John Major experienced a tremendous loss of credibility, as well as did the institutions responsible for regulating the financial and monetary markets (Cobham, 1997: 1131). To some degree, the Black Wednesday crisis was seen as a failure of the Conservative government, and the British voting public responded by electing new leadership from the New Labour Party.

The New Labour party has taken financial globalization very seriously since its election into government in 1997. In 2000, this administration made its opinions about the need to control the domestic financial market especially clear through the Financial Services and Markets Act 2000 (FSMA 2000) (Lutz, 2004: 181). This act provided for a revision of previous legislation enacted during the 1980s whose goal at the time was to oversee financial regulation. However, it had become painfully clear to the British government during the 1990s that the financial markets had changed and that their former system of regulation had become outdated (Spalek, 2001: 76).

The new version of the bill solidified the move within the government to shift the primary responsibility for regulation from an emphasis on self-regulation to institutionalized regulation, which suggests a desire of the government to play a more direct role in matters relating to the financial markets (MacNeil, 1999: 725). Thus, the responsibilities for financial regulation were divided between Her Majesty's Treasury (Treasury), the Bank of England (BoE), and the Financial Services Authority (FSA) as explicitly laid out in the Memorandum of Understanding 2006; each of these parties is responsible for specific regulatory tasks but all serve under the direction of government policy. In this way, the New Labour administration has hoped to make regulation of the global financial market more efficient and more secure.

Her Majesty's Treasury

The Treasury is the United Kingdom's economics and finance ministry. Its primary responsibility is to formulate and implement the British government's financial and economic policy, and it reports directly to the Parliament. As such, the Treasury is the 'official' government arm of the three-dimensional approach to financial regulation as set out by the FSMA 2000. Essentially, the Treasury is responsible for overseeing the Bank of England and the Financial Services Authority and for mediating between these two agencies and the British Parliament. More specifically, its responsibilities include

- overseeing the overall institutional structure of financial regulation and legislation;
- informing Parliament of problems within the financial system and the measures taken to resolve those problems;
- accounting for financial sector resilience to operational disruption within government (Financial Services Authority, 2006).

Clearly, the Treasury's responsibilities under the FSMA are reflective of the breath-approach to regulation as they are more general in scope.

However, what is curious about these responsibilities is that even though this department has the closest affiliation with the government, the Treasury has no operational responsibilities for financial management. Moreover, the BoE and the FSA reserve the power to inform the Treasury on a need-to-know basis following their own discretion rather than government mandate (Financial Services Authority, 2006). To be sure, the British government has made a strong statement here regarding their desire for involvement in the financial markets. Yet, from the perspective of state sovereignty, this 'hands-off' approach to regulation does not necessarily signal a loss of sovereignty. Instead, the FSMA 2000 and consequent division of responsibilities was enacted under the sole discretion of the British government; these policies were chosen by the government not for the government. In addition, it is important to note that while the BoE and the FSA have been given the primary responsibilities in regulation, the Treasury still oversees their operation and creates the legislation upon which these agencies base their operations. Thus, the division of authority over the financial market has changed since the days prior to financial globalization, but the final authority still rests firmly in the hands of the state by way of the Treasury.

Bank of England

The efforts at restructuring the banking system in England were a high priority of the New Labour government (Lutz, 2004:181). Consequently, the reforms made to the Bank of England are an important part of the FSMA 2000. The primary responsibilities of the BoE according to the reforms include

- ensure the stability of the monetary system;
- oversee UK payments systems domestically and internationally;
- maintain a broad overview of the system as a whole;
- intervene in other financial operations to prevent widespread problems throughout the system (Financial Services Authority, 2006).

These policy objectives were designed primarily to regulate the monetary system, which is inexorably tied to the financial markets. According to Kirshner (1995: 29), 'monetary power is a remarkably efficient component of state power,' and currency manipulation is a central component of this monetary power. For the United Kingdom, the chosen avenue for the retention of its monetary power has been to firmly solidify it in the responsibilities of the Bank.

In addition, implicit in the responsibilities given to the Bank of England are the British efforts to respond to the challenges of financial globalization. In particular, the Bank of England has been given responsibilities designed to respond to the advances in information technology that have led to the increase in currency speculation and use of electronic currency. It has already been argued that financial globalization presents a challenge to state sovereignty through the proliferation of information technology and its role in facilitating the use of e-currency and speculation. However, the advances in information technology have also enabled the BoE to 'turn the information technology to their advantage, using it to track the linkages in the financial system and make those linkages safer' (Bank of England, 1998: 4). Consequently, the Bank of

England has begun embracing the advances in information technology as new avenues by which to control for its challenges. For example, the Bank of England has employed real-time gross settlement (RTGS) technology that enables funds to transfer in real-time as opposed to waiting until the end of the day. This technology allows the Bank to monitor transactions as they occur and to immediately decipher problems that may arise due to the speed of these transactions or any illegal activity (Bank of England, 1996). By embracing technology, the Bank can more closely and more quickly monitor market activity for the purposes of preventing speculation or monetary/financial crime from becoming unmanageable. Thus, the restructuring of the BoE is evidence of a desire to retain control over speculation and electronic currencies that have become so prolific due to advances in communication technologies.

Financial Services Authority

The Financial Services Authority (FSA) was updated in 2000 to specifically address the challenges presented by a technologically-driven, global financial market. Although the FSA is an independent non-governmental body, it remains accountable to Parliament through the Treasury. Under the Financial Services and Markets Act 2000, the four statutory objectives given for the FSA include

- market confidence: maintaining confidence in the financial system;
- public awareness: promoting public understanding of the financial system;
- consumer protection: securing the appropriate degree of protection for consumers;
- reduction of financial crime: reducing the extent to which it is possible for a business to be used for a purposed connected with financial crime (Financial Services Authority, 2006)

The creation of the FSA in the United Kingdom was part of an international trend to divert the increasingly complicated regulation of financial markets to an independent agency whose sole focus would be these markets (Lutz, 2004: 192). Governments quickly discovered in the late-

1990s that the internet made it possible for high volumes of financial transactions to occur at a rapid pace by a number of consumers. Consequently, the plan was devised to create a unitary regulator whose sole responsibility would be to monitor the financial market. This was largely a response to the trend that ‘as financial groups have become more complex incorporating a range of different financial businesses and have begun to operate on a global basis,’ the number of regulators had grown to over 150 agencies in the United Kingdom (Bank of England, 1997: 110). Consequently, the establishment of the FSA allowed the government to consolidate its regulatory efforts to make them more efficient and effective.

Financial firms are supervised by the FSA according to the potential risk they pose for increasing the volatility in the larger financial market. Risk is determined by a scale measuring both potential impact and probability of financial failure and is assessed on a regular basis. Once risk is determined, firms are classified as either medium to high-impact firms or as low-impact firms; the difference between these two classifications refers primarily to the level of damage their private failures could cause for the larger market as well as the consequent amount of detailed attention paid to the specific firm. High-impact firms are monitored very closely and even have their own ‘relationship manager’ who carries out regular risk assessments, establishes a risk mitigation program, and checks for compliance with these programs. For the low-impact firms, regulation is done on an aggregate scale, drawing from the belief that small firms are only a threat to the larger system as a collective (Financial Services Authority, 2006). Consequently, the small firms are placed in contact with the Firm Contact Centre who performs the same functions as a relationship manager but on a less-individualized scale.

In addition to supervision, the FSA is also engaged in the business of enforcement. In fact, the agency is fully-funded by the firms it serves; their fines for misconduct help to fund future regulation. Additionally, due to the supervision of the Treasury, the FSA is able to present repeat-offenders or other high-risk firms directly to Parliament for further regulation and penalties (Financial Services Authority, 2006). This allows the government to still retain control over the market and its major players without getting bogged down in the daily regulatory functions. Thus, the FSA has proven to be a useful tool for the maintenance of state control over the globalized financial market.

Global Response

Along with these domestic-level responses, the United Kingdom, like many other states, has chosen to respond to the challenges of financial globalization at the global level. The tendency to respond to financial globalization at both the domestic and global level is due in part to the very nature of globalization where there is a unique connection between the domestic and the global/international. In other words, just as globalization presents both domestic and global challenges to the state, it also serves as the context through which a state responds to its challenges domestically and internationally (Yeung, 1998: 293).

The United Kingdom has responded to the challenges of financial globalization by participating in a number of international organizations, such as the United Nations (UN), the World Trade Organization (WTO), the Bank for International Settlements (BIS) and the International Monetary Fund (IMF). Here, however, the focus of this investigation will rest on the two most important examples of the United Kingdom’s international response to financial globalization, which are participation in the Organization for Economic Cooperation and Development (OECD) and the European Union (EU). Participation in these two organizations has served as the British government’s primary way to respond to the challenges of financial globalization that cross domestic borders, particularly the challenges of contagion and external pressures. Consequently, the response to financial globalization at this level is meant to address the final two components of sovereignty, which are (1) the ability to exclude external pressures from the domestic decision-making process on financial regulation and enforcement of that regulation and (2) the ability to enter voluntarily into binding agreements between other nation-states and non-state financial firms, which includes the ability to join regional or international organizations and willingly submit to their governance measures. Thus, the success of the international responses of the United Kingdom to financial globalization will be evaluated as a second illustration of the extent to which financial globalization challenges state sovereignty.

Organization for Economic Cooperation and Development

On 14 December 1960, 20 states came together to form the Organization for Economic Cooperation and Development (OECD). The OECD had its roots in the Organization for European Economic Cooperation (OEEC), which was created after World War II for the purposes of promoting democratic values and free market economies. In 1960, membership in the organization was extended to states outside of Europe, and so the name was changed (OECD, 2007).

Even from the beginnings of the organization, the OECD recognized the change taking place in the international markets. In the preamble of their founding agreement, called the Convention, the members agreed that after 'recognizing the increased interdependence of their economies' cooperation would be necessary among their governments in order to ensure stability and peace (OECD, 1960). Thus, even though the OECD was founded before the era of globalization, the system of interdependence that proceeded and led to globalization was recognized by these states as a phenomenon worthy of their attention. Even more specifically, financial stability was recognized in the Convention as an increasingly important issue to be addressed within the OECD as the system of interdependence intensified (OECD, 1960). Today, the OECD remains committed to the principles of cooperation as globalization continues to advance. It has become commonplace for the members of the OECD to recognize that 'improved internal policy coordination mechanisms are essential for meeting the challenges of globalization and for playing an effective international role' (OECD, 1995: 3). This is certainly the case for the United Kingdom; membership in the OECD represents a way to respond to the challenges of financial globalization that traverse international borders.

Among the most important of these challenges are the possibility of contagion of crisis and external pressures on domestic decision-making. Since both of these challenges involve more than one domestic economy, it is imperative to turn to international cooperation as a means of responding to these issues. For example, in the case of contagion, international cooperation through the OECD provides a forum for open communication between states, which is an important element in preparing the international and domestic markets for volatility and crises (OECD, 1995: 2). Greater transparency between states has long been recognized as an effective means to control for international crises as it would enable states to foresee instability and thus prepare for it (Watson, 2002: 1999). The OECD serves as an avenue for encouraging greater transparency, because there is an emphasis placed on information sharing, communication between states, and policy coordination all of which can lead to greater transparency (OECD, 2007). Here, the context of an international organization is key, since it is more appropriate for the British government to expect transparency from other states when those are also in a position of expecting that from the British.

The principle of reciprocity also applies in the context of responding to external pressures on domestic decision-making. As a founding member of the OECD, the United Kingdom has a particularly powerful voice in negotiations and policy formulation. In fact, it has been suggested that 'the British government has been the most consistent, vociferous and unyielding advocate of a global regime of free trade and free capital mobility' (Hay and Smith, 2005: 133). This suggests that the OECD has allowed the British government to respond to the external pressures of the United States and other international organizations by becoming a vocal and powerful member of this organization. Within the context of the OECD, the British government can respond to the challenges set forth by the United States as well as develop international policies that suit the domestic aims of the United Kingdom.

Nevertheless, it is important to recognize that, even in the context of the OECD, the British government still faces tremendous external pressures on their domestic decision-making process. This is evident even in the requirements for membership in the organization, such as the sharing of information and deregulating border controls. Thus, this suggests a serious challenge to state sovereignty in this area. However, it is important to note that the ability to enter voluntarily into agreements where sovereignty may willingly be surrendered is also considered a component of the definition of state sovereignty as outlined in this study. Still, many scholars would say that membership in the OECD and other international organizations has ceased being voluntary and has since become compulsory for any state wishing to participate in the international market (Li and Smith, 2002). A thorough investigation into this complex argument certainly warrants the attention that cannot be afforded to it here. However, it is significant to note that regardless of whether or not membership in the OECD was voluntary, the British have used this membership as a platform from which to advocate their own interests and to challenge the interests of other states. In this way, membership in the OECD represents a powerful response to the challenges of financial globalization that suggests the staying power of state sovereignty.

The European Union

In addition to seeking membership in the OECD, the British government has responded to the challenges of financial globalization by seeking cooperation with the European Union (EU).

Similarly to the OECD, the European Union was established after World War II as a way to promote peace and prosperity through the principles of democracy and free market economies (European Communities, 2006). In keeping with these principles, the EU has sought after political and economic stability within the member countries as well as in the neighboring states of the Union. The efforts at stability have not always been successful as evidenced by the ERM crisis in 1992, for example, but the European Union provides another forum to improve interstate cooperation in an effort to respond to the challenges presented by financial globalization.

Among its many efforts to respond to the challenges of financial globalization, the EU has worked to increase transparency in policy design and implementation, improve the flow of inter-state communication, and strengthen domestic financial systems all with the goal of preventing domestic and international crises (European Union, 2002: 9). These efforts are accomplished through the institutions of the European Union that provide forums for communication, monitor domestic and regional markets, and collect and distribute funds to subsidize poorer domestic markets. The significance of these efforts by the EU is the same as the OECD, namely that the EU provides 'governance at a level beyond national borders' (European Union, 2002: 23). As was seen in the discussion of the OECD, this supra-national level of governance has become critical in an era of financial globalization where challenges to state sovereignty are at times the result of global or supra-national events rather than anything that can be controlled at the domestic level. Still, in the case of the United Kingdom, the European Union is not an entirely obvious response to financial globalization given the fact that the UK is not a member of the Economic and Monetary Union (EMU). Consequently, the United Kingdom does not benefit from the monetary and financial policies associated with the EMU, but it does benefit indirectly from the stability these policies create within Europe.

The importance of regional stability was seen in the East Asian Crisis. There, contagion occurred at such a dramatic level because the markets in state neighboring Thailand were also unstable (Das, 2003). Thus, for the United Kingdom, encouraging the EMU by participating in the European Union is a way to control for the potential for regional crises and contagion. The logic follows that if the economies of the EMU are stable, it will only improve the stability of the British domestic economy. Moreover, even though the United Kingdom is not a member of the EMU, it still has an indirect voice in the policies enacted through the EMU due to its position within the European Union. Thus, the United Kingdom still plays an important role in the EU and the EMU, which has the benefit of encouraging regional policy that serves the interests of the British.

Even though the United Kingdom is not a member of the EMU, its membership in the European Union is still seen by the British as a response to financial globalization. Furthermore, the possibility of joining the EMU sometime in the future is very real for the British:

> Blair's comments … are again indicative: 'in a world that is moving closer together and being transformed by globalization, it would be a cruel denial of our own proper self-interest to cut ourselves adrift from the major strategic, economic and political alliance right on our doorstep'. (Hay and Smith, 2005: 144)

Clearly, the British have and continue to take the European Union and the EMU seriously as a response to the challenges presented by financial globalization. Moreover, their ability to decide for themselves when the appropriate time is to make this transition shows that the British sovereignty in this area is still very much intact. Thus, in the broader picture of financial globalization, the states who have chosen to respond to the challenges of financial globalization by turning to regional organizations are still acting within the realm of their sovereign powers. In these cases, these states have chosen to surrender elements of their sovereignty in favor of a system of pooled sovereignty, where power is shared collectively over certain issues. The important part of this process for this investigation is that states *chose* this process, and because of the ability to make this choice, regional integration and other expressions of pooled sovereignty are not considered to be indicators of a loss of domestic sovereignty. Consequently, participation in the European Union and remaining open to membership in the EMU represent an important response of the United Kingdom to the challenges of financial globalization that testifies to the stability of state sovereignty.

Conclusion

Given our discussion of the challenges of financial globalization, it is hard to believe that any state could deny the realities of financial globalization. For the United Kingdom, the challenges of financial globalization are taken very seriously. As such, the British government has responded to these challenges in a way that aims to retain sovereignty over the domestic and global financial market. In examining this response, the breadth-approach presented here led to an investigation of both the domestic-level response and the global-level response. At the domestic level, reforms have been made to the Treasury, the Bank of England (BoE) and the Financial Services Authority (FSA) in an effort to retain sovereignty, especially in light of the challenges presented by technology, non-state actors and speculation. Here, the two elements of sovereignty that were specifically addressed are (1) the ability to control movement of financial goods and services across state borders and (2) the ability to regulate domestic financial activity through legislation and institutions. At the global level, the government of the United Kingdom sought out international cooperation with the Organization for Economic Cooperation and Development (OECD) and the European Union (EU) as a way to respond particularly to the challenges of contagion and crises as well as external pressures. At this level, the response to financial globalization addresses the final two components of sovereignty, which are (1) the ability to exclude external pressures from the domestic decision-making process on financial regulation and enforcement of that regulation and (2) the ability to enter voluntarily into binding agreements between other nation-states and non-state financial firms, which includes the ability to join regional or international organizations and willingly submit to their governance measures.

The success of these responses at the domestic and international levels show that states have been able to maintain their sovereignty even in the face of the serious challenges presented by financial globalization. The expression of state sovereignty is clearly different in the context of financial globalization, as evidenced by the presence of independent regulators at the domestic level and by the pooling of sovereignty at the international level. Yet, it is important to remember that states have chosen to respond to financial globalization in these ways and that, since the late-1990s, these responses have successfully prevented financial market failures in the United Kingdom and in many other parts of the world.

CHAPTER 4
CONCLUSION

If there ever was a word to describe the 1990s, it would be globalization. This phenomenon has been the subject of political and academic debates and inquiry, but few definitive conclusions about globalization have been reached. Among the many debates surrounding globalization is the debate over the extent to which globalization represents a threat to state sovereignty. The aim of this project has been to investigate this relationship with a particular focus on financial globalization as a challenge to state sovereignty.

As the starting point for this investigation, financial globalization has been defined as the increasingly digital market where currencies, assets, loans, derivatives, and credit are traded by state and non-state firms across deregulated borders. As a secondary element to this definition, the spread of financial globalization has coincided with increased levels of regional integration that serve as a way for states to control for the adverse effects of globalization. In conjunction with this definition, state sovereignty has been defined as (1) the ability to control movement of financial goods and services across state borders, (2) the ability to regulate domestic financial activity through legislation and institutions, (3) the ability to exclude external pressures from the domestic decision-making process on financial regulation and enforcement of that regulation, and (4) the ability to enter voluntarily into binding agreements between other nation-states and non-state financial firms. While neither of these definitions are meant to be the final word on the process of conceptualizing these terms, the definitions presented here do serve as a foundation for the basic argument of the paper.

Even though it was the initial goal of the researcher to join the chorus proclaiming the end of the sovereign state, the findings presented in this study cannot support that initial perspective. Consequently, I have argued that financial globalization has significantly change the pre-1990 conceptualization and practice of state sovereignty but has yet to present a challenge significant enough to completely undermine state sovereignty. The challenges presented by financial globalization that were emphasized here included: information technology and the internet, non-state actors, speculation, crisis and contagion, and external pressures on domestic decision-making. Each of these challenges were presented highlighting their impact on the domestic and international markets of the United Kingdom. Then, the state response to these challenges was investigated paying particular attention to the response of the United Kingdom, which featured both domestic and global responses. From a perspective that emphasized breadth, the domestic responses investigated focused primarily on the restructuring of the Treasury, the Bank of England, and the Financial Services Authority as a means to control for technology, non-state actors, and speculation. At the global level, the emphasis was placed on the United Kingdom's participation in the OECD and the EU as a means of controlling for contagion and external pressures.

In the end, the successful implementation and continuation of these responses to financial globalization were determined to have shown that states have been able to maintain their sovereignty even in the face of serious challenges presented by financial globalization. While the expression of state sovereignty in these examples was clearly different from previous years, this change in sovereignty has not been seen as signaling an end or undermining of sovereignty, although some scholars might see them as the same. Instead, the change in the expression of sovereignty was seen as a prerogative of the state—an expression in itself of the state's sovereignty—and is not equated with an end to sovereignty. Thus, at this point in time, financial globalization does not represent a fatal threat to state sovereignty.

As with any project that takes on a complex topic, there is an important limitations of this study that needs to be addressed. For any study that seeks simplicity, there is a trade-off in complexity and richness; the many concepts addressed in this study (such as financial globalization, state sovereignty, non-state actors, contagion, and pooled sovereignty to name a few) are incredibly complex and heavy with theoretical and empirical implications. In this study, however, it was necessary to give these concepts a simpler treatment for two reasons. First, one of the goals of this project was in fact to simplify these concepts in order to more clearly define and apply them. Part of the challenge to the greater literature on globalization has been the complexity of these terms, but here the goal was to remove some of the complexities in order to address the debate from a new angle. Secondly, given the limitations imposed by the nature of this study, it would simply be impossible to give adequate treatment to each of these concepts. Thus, the simplification was also a matter of convenience to enable the project to move forward.

While this study has traded complexity for simplicity, it was done so purposefully so as to provide a micro-level study that could speak back to the macro-level debate. The literature on globalization has reached a juncture where it is becoming increasingly important to accept the risks of simplification for the purposes of moving forward in this research area. If scholars and politicians continue to speak and think only in complexities, it is unlikely that globalization as a broader concept will ever be defined or fully investigated empirically. While some might see this as a strength in itself, it is also working to keep the field trapped in the same debates it has been facing for over two decades. Thus, this project has willingly accepted the limitations imposed by simplicity for the aim of ultimately applying this study back to the broader field.

While this project has focused exclusively on financial globalization, the ultimate aim of this project is to bring greater understanding to the phenomenon of globalization as a whole. As was stated previously, the lack of progress in research on globalization has often been attributed to the inability to solidly define the key elements of globalization and other related concepts such as state sovereignty. Thus, one of the strongest points of this investigation is the attempt to solidify the definitions of financial globalization and state sovereignty for the purposes of applying those definitions to both theory and empirics. Throughout this study, the conceptualizations of these two terms have proven workable in their application to the empirical example of the United Kingdom in the 1990s. Here, these concepts are proven to be more than just conjecture or academic speculation as they are in fact reflective of actual phenomenon. As such, these definitions possess the potential for further applications in other states and in other time periods, because they have been proven applicable in this context.

A second strength of this project is its ability to tie together the broader literature on financial globalization with the empirical examples provided by the United Kingdom during the 1990s. Even though this project is not designed to be a case study, drawing on empirical evidence has grounded the investigation in a way that gives it more credibility and applicability. This project has attempted to go beyond the confines of the literature of financial globalization to actually investigate how financial globalization plays out in the real world and how well the theoretical arguments about financial globalization apply in these contexts. As such, this project brings back to the debates concrete concepts and examples from which scholars can more forward, either further proving or refuting. For too long, the debate on the impact of financial globalization on state sovereignty has remained abstract and conjectural, but this study enables this debate to move forward both theoretically and empirically in a very concrete way.

Consequently, a third strength of this project is the foundation it provides for future research. As was stated previously, this project encounters a serious limitation in depth.

However, this limitation should also be recognized as a strength, because it provides a foundation for a number of avenues for future research. Any one of the challenges of financial globalization or the responses of state sovereignty could be investigated as distinct subject areas for the purposes of further enhancing the overall picture of financial globalization. Moreover, the application of this study to the United Kingdom could be further investigated in an in-depth case study or translated to other specific states or to trends across time or space. This project is therefore successful in its aim to provide a foundation for future avenues of research, all of which will continue to benefit the growing research area of globalization.

In the end, the true merit of this work will rest on the successes of the research that comes after it. This investigation into the theoretical and empirical relationship between financial globalization and state sovereignty in the United Kingdom shows that the conclusion of this debate is not out of reach but that there is also still much work to be done to reach this end. What this project can promise, however, is that the future of globalization research is full of endless possibilities and exciting discoveries yet to be made. This is truly an exciting time to be part of the globalization dialogue.

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BIOGRAPHICAL SKETCH

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