Since the demise of the Bretton Woods system, a system where regulations on cross-border capital flows were a global norm, the world community has lacked a forum for governing global capital flows. In the meantime, cross-border capital flows have increased by orders of magnitude, so much so that international asset positions now outstrip global economic output. Most cross-border capital flows occur among industrialized nations, but emerging-market and developing countries (EMDs) are increasing participants in the globalization of capital flows. Although it is widely recognized that capital investment is an essential ingredient for economic growth, there is a growing concern that certain capital flows can be destabilizing to EMD financial systems by causing asset bubbles, that is, exchange rate appreciation during periods of massive capital inflows followed by sudden stops and capital flight that can jeopardize stability and growth (see Ocampo, Kregel, and Griffith-Jones 2007).

There is a long history of debate over volatile capital flows and the appropriate government policies relating to them. The global financial crisis has opened a new chapter in this debate because pro-cyclical capital flows have been characteristic throughout (Chinn and Frieden 2011; IMF 2010a, 2010b). At the turn of the twenty-first century, many international financial institutions and strands of economic thinking remained either hostile to or silent regarding regulating capital movements. In this chapter, I outline a modern history of the governance of cross-border capital flows from the founding of the International Monetary Fund (IMF) to the turn of the twenty-first century.
There is a vast literature on this subject, and by no means is this short chapter to be seen as a comprehensive review of that literature. In this chapter, I synthesize that literature to provide a backdrop for the chapters to come, which examine the global governance of capital flows.

The IMF governance of capital flows is a regime of cooperative decentralization, and this regime has been contested since at least the 1970s. Despite such contestation, EMDs and interests in the industrialized world were able to stave off attempts in the late 1990s to shift the IMF toward strong international standards that would have mandated the free flow of capital under the IMF Articles of Agreement. I discuss the Bretton Woods era and then examine the period from the 1970s until the Asian financial crisis. In the succeeding chapters, I analyze the period from the Asian financial crisis to the global financial crisis and its aftermath.

Cooperative Decentralization: The Bretton Woods Era

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

Under the umbrella of the IMF articles, the regime for governing capital flows could be characterized as, to use Eric Helleiner and Stefano Pagliari’s (2011) term, cooperative decentralization. Cooperative decentralization is a regime where there is interstate cooperation across divergent national regulatory approaches. This stands in contrast with what they term strong international standards, characterized by interstate cooperation and global regulatory convergence across national systems of regulation. The IMF Articles of Agreement are actually an example of both. The Articles set out that no country may restrict current transactions—all profits and dividends from foreign transactions must be able to flow freely and without delay among IMF members around the world. This is enshrined in the IMF and is now echoed at the World Trade Organization (WTO), where a nation can restrict current transactions only if the IMF sanctions it. With respect to the capital account, however, the IMF allows for national diversity in terms of regulating capital flows and permits nations to cooperate to monitor and enforce such regulations on a multilateral basis. The distinction is this: strong international standards are universal and cannot
be deviated from; cooperative decentralization allows for arrangements where nations can pursue their own national policies but coordinate them on a multilateral level. Louis Pauly summed up the regime as “reconcil[ing] increasingly liberal external relations with the retention by individual states of their right to intervene in their internal economies” (1997, 80).

Forging the Global New Deal

The Bretton Woods conference was envisioned as resulting in a “New Deal in international economics,” according to US Treasury Secretary Henry Morgenthau and other core negotiators at the conference (Helleiner 2011a). In that vision, the meetings yielded an IMF that would help provide what Charles Kindleberger (1986) referred to as the five core public goods to maintain global economic stability while also granting nations the flexibility to pursue their own domestic objectives. Those five public goods are:

- Maintaining open markets during recessions
- Providing countercyclical lending
- Policing exchange rate stability
- Coordinating macroeconomic policy
- Acting as a lender of last resort

The embryo of these ideas was the League of Nations that had preceded the Bretton Woods institutions (Pauly 1997), but it was at Bretton Woods that the creation of the IMF, the World Bank, the General Agreement on Tariffs and Trade (GATT), and the fixed but adjustable exchange rate system was intended to provide such goods in the post–World War II era. The middle three public goods—countercyclical lending, exchange rate stability, and macroeconomic coordination—are, of course, strongly connected with the cross-border movement of financial flows.

The core framers of the IMF Articles were Harry Dexter White, who represented the United States, and John Maynard Keynes, of Great Britain. The differences between these two men and their countries over what a post-war international monetary system should look like were notorious and large (Skidelsky 2000; Steil 2013). Interestingly, relatively less attention has focused on the fact that they agreed on at least two things: that it was important for nations to have the freedom to regulate capital flows and that nations should cooperate to render those regulations effective (Thirwall 1974; Helleiner 1994; Boughton 2002; Abdelal 2007).

Both Keynes and White saw capital flows as concerning. For White, regulating capital flows was a second-best strategy; for Keynes, capital controls were
second nature (Boughton 2002). Both men saw the need to regulate speculative capital flows because of the impact that such flows could have on the policy autonomy of the welfare state and on exchange rate stability (Helleiner 1994). Although the formal Mundell-Fleming model had not yet been articulated (see chapter 3), these economists had the insight to see that the free movement of capital was not compatible with a fixed exchange rate and an independent monetary policy. The free movement of capital can throw off the ability of nations to expand and contract their economies. In such an environment, lowering the interest rate to expand the domestic economy could trigger capital flight rather than domestic investment; raising rates could attract ever more capital at exactly the time when cooling off an economy is called for. Such pro-cyclical capital flows also put real pressure on the exchange rate and can cause balance-of-payments problems. This concern was echoed by the League of Nations report written by Ragnar Nurkse (1944).

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

These proposals drew significant support from EMDs during the deliberations at Bretton Woods. According to new archival work by Helleiner (2014a), Latin American countries wanted to make sure that they could maintain their capital and exchange controls during the negotiations and also supported the need for international cooperation mechanisms on capital flows. China was also very supportive. Helleiner notes that China had its own full-blown plan for a new international system. In it, Chinese officials were also supportive of the US and British plans concerning capital controls, particularly the provisions for the use of cooperation which they hoped might help China to control outgoing flight capital. Each member of the China’s Fund would be required “upon request, to cooperate with any other member nation that may regulate international capital movements.” Echoing the White plan, each member country could be asked “(1) to prohibit in its jurisdiction acquisition of deposits or other assets
by nationals of any member nation imposing restrictions of capital transfers except upon authorization of the latter nation; (2) to furnish the Government of any member nation on request full information regarding such deposits and other assets; and (3) to consider such other measures as the Board may recommend” (Helleiner 2014a, 195).

Box 2.1 lists the key components of the IMF Articles of Agreement that pertain to global capital flows. The clear language granting nation-states the ability to deploy capital controls is found in Article VI, Section 3: “Members may exercise such controls as are necessary to regulate international capital movements.” Article VI, Section 1 allows the IMF to request that a nation put in place capital controls and even permits the IMF to withdraw support if such a request is not granted. In Article VIII, Section 2(b), we find the language on cooperation: “members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective.” This language does not require cooperation, as White and Keynes had hoped, but it does stress the importance of cooperation. Other parts of Article VIII, in Section 5, grant the IMF authority to collect data on both capital flows and on the nature of capital controls—thus arming the institution with the information that individual nations will not have to help nations identify the sources of capital flows and where to turn for cooperation.

Box 2.1: Capital Controls in the International Monetary Fund Articles of Agreement

Article VI: Capital Transfers

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

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

(b) Nothing in this Section shall be deemed:

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

(ii) to affect capital movements which are met out of a member’s own resources, but members undertake that such capital movements will be in accordance with the purposes of the Fund.
Section 3. Controls of capital transfers
Members may exercise such controls as are necessary to regulate international capital movements, but no member may exercise these controls in a manner which will restrict payments for current transactions or which will unduly delay transfers of funds in settlement of commitments, except as provided in Article VII, Section 3(b) and in Article XIV, Section 2.

Article VIII: General Obligations of Members
Section 2. Avoidance of restrictions on current payments
(b) Exchange contracts which involve the currency of any member and which are contrary to the exchange control regulations of that member maintained or imposed consistently with this Agreement shall be unenforceable in the territories of any member. In addition, members may, by mutual accord, cooperate in measures for the purpose of making the exchange control regulations of either member more effective, provided that such measures and regulations are consistent with this Agreement.

Section 5. Furnishing of information
(a) The Fund may require members to furnish it with such information as it deems necessary for its activities, including, as the minimum necessary for the effective discharge of the Fund’s duties, national data on the following matters:

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

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

Source: IMF (2013a).

Capital Flows and the Golden Age of Capitalism
As noted earlier, scholars generally agree that the regime of cooperative decentralization for governing capital flows worked “more or less as planned” during the Bretton Woods era but began to break down in the early 1970s. A large number of nations, including the United States, deployed capital controls during this period with some success. Although in a more limited fashion than White and Keynes would have hoped, there was a certain degree of international cooperation on the regulation of cross-border finance as well.

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

The 1960s have been characterized more as a period of unilateral regulation, although in some ways they could be seen as coordinating rather than explicitly cooperating. During the John F. Kennedy administration, the United States was engaged in expansionary monetary policy and was concerned that low interest rates would trigger excessive capital outflows. The European nations were battling inflation and were concerned that high interest rates might attract more capital at exactly the time when they wanted to cool their economies. Many European nations thus regulated the inflow of speculative capital while the United States regulated capital outflows. And the United States pushed Canada (which was exempt from US controls on outflows) to “plug the hole” that allowed US capital to leak into Europe through the Canadian exception to the US regulation (Hawley 1987). Aside from the US-Canadian case, Helleiner (1994), who has studied this period the closest, does not indicate that nations explicitly cooperated on regulating capital flows. Nevertheless, the United States and Europe had coordinated their actions implicitly, given that they put controls on both ends, as Keynes had suggested.

Indeed, it may come as a surprise to many to learn that the United States deployed capital controls fairly successfully during the Bretton Woods era. The United States regulated outflows of speculative capital for close to ten years (1963–1973).

And for a very brief period, it regulated inflows as well. Between 1969 and 1970, capital inflows from the Euromarket were making it difficult for the US Federal Reserve (the Fed) to limit domestic credit. Thus in 1969, the Federal Reserve restricted the ability of Eurodollar borrowing by US banks. First, the Federal Reserve attempted to have US banks do this on a voluntary basis, but then it officially put a 10 percent reserve requirement on domestic borrowing from US banks in the Euromarket. The Fed attempted to establish a reserve requirement in 1979 as well. Moreover, it pushed hard for the Bank of International Settlements to require that nations cooperate with the US proposal. Both of these later efforts failed (Helleiner 1994).

The most significant capital controls in the United States were controls on outflows. In the 1960s, the United States was engaged in an expansionary
monetary policy (and ramping up for the Vietnam War), but it was also experi-
cencing balance-of-payments problems (Block 1977). After weighing a series of
alternative policies, the United States enacted the Interest Equalization Tax (IET),
a 15 percent tax on the purchase of foreign equities. For bond trades, the tax va-
riety depended on the maturity structure of the bond, ranging from 2.75 percent
on a 3-year bond to up to 15 percent on a 28.5-year bond. Borrowers looking
to float bonds would thus pay approximately 1 percent more than interest rates
in the United States, thereby flattening the interest rate differential between the
United States and Europe (Hawley 1987).

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

The IET immediately changed the composition of US outflows of capital, but
it took longer for it to effect the balance of payments. In an early study, Richard
Cooper concluded that “The IET was highly successful in its narrow objective;
taxable new foreign issues in the United States virtually ceased, and net acquisi-
tions of outstanding foreign securities by Americans became fairly substantial
net liquidations after the tax proposal” (1965, 469). But Cooper went on to note
that the IET had not, by 1965, shown a significant change in the US balance-of-
payments position. A later analysis by the US Congress concluded, however, that
“The Interest Equalization Tax was first made effective in the middle of 1963 and
used in conjunction with the limitations on extensions of credit and direct bal-
ance of payments problem. Measured on a liquidity basis, the deficit fell from an
average of 2.5 billion dollars in the years 1961 through 1964 to 1.3 billion dollars
for 1965 and 1966. In 1967 the deficit increased to 3.5 billion dollars and in 1968
a surplus of 93 million dollars was recorded” (Butterworth 1970, 172).

Despite the limited level of cooperation among nations, numerous studies
show that capital controls were effective outside the United States during this
period as well. Work by Maurice Obstfeld (1993), Richard Marston (1993),
and Penti Kouri and Michael Porter (1974) demonstrate that controls were ef-
fective to the 1960s in the United Kingdom, Germany, Australia, Italy, and the
Netherlands.
As the Bretton Woods system of exchange rates began to unravel in the 1970s, there was a last round of cooperation that led Europe to push for explicitly granting the IMF more power to mandate cooperation on capital controls, as Keynes and White had once urged. France convinced the United States to maintain its capital control on outflows in 1972 so France wouldn’t suffer the currency appreciation of heavy inflows of capital from the United States. During the same period, France convinced Germany to tighten capital controls on outflows so France would not suffer the consequences of excessive inflows of speculative capital. Such efforts did not last long, and efforts to reinstate the requirement to cooperate was neutralized by the US banking community (Helleiner 1994; Webb 1995; Chwieroth 2010a).

The Political Economy of Regulating Capital in the Bretton Woods Era

Why and how did the immediate era following the Bretton Woods era work more or less as planned? A large literature has emerged that attributes these changes to political power and interest-group politics, prevailing economic ideas, and institutions.

Table 2.1 contrasts how these forces interacted during the Bretton Woods era with how they interacted during the period from the collapse of the gold-dollar standard to the turn of the twenty-first century. The Bretton Woods era has been characterized as a period when the United States was a benevolent hegemon, the US financial sector was not as strong as in later periods, Keynesian ideas prevailed, and the world economy largely operated under the rubric of the IMF Articles.

In terms of power, Helleiner (1994) has depicted the United States as a benevolent hegemon with respect to capital controls during this period. The United

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<td><strong>BRETTON WOODS</strong></td>
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Note: AFC, Asian financial crisis.
States permitted capital controls in other nations because of concerns relating to the cold war. Policymakers in Japan and Europe saw controls as essential to their growth strategies, and the United States saw enabling growth and maintaining alliances with those nations as a high priority. Moreover, as we have seen, the United States itself deployed controls for over ten years during the period.

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

In terms of ideas, the construction of the Bretton Woods system reflected the prevailing mode of thought (at least in the United Kingdom and United States, where the institutions were framed) of embedded liberalism, the dominant thinking about international economic regimes and domestic policy at the time that stressed the need for nations to strike their own balance between global economic integration and the democratic enhancement of national welfare (Ruggie 1982). “Embedded liberals argued that capital controls were necessary to prevent the policy autonomy of the new and interventionist welfare state from being undermined by speculative and disequilibrating international capital flows” (Helleiner 1994, 4). This thinking was backed by a coalition of Keynesian-minded policymakers, industrialists who gained from such a policy, and labor leaders. Indeed, this period is seen as the heyday of the Keynesian revolution in economics.

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

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

By the 1990s, the industrialized countries had shifted their thinking and action on global capital flows. By end of the century, virtually all industrialized countries
had fully opened the capital account, and many EMDs had followed suit. These changes reflected technological changes in the financial industry, larger global capital markets, and an associated political strengthening of the financial sector, along with new thinking in macroeconomics. As the twentieth century closed, industrialized nations moved to formalize this thinking through strong international standards on all fronts—at the IMF, the Organisation for Economic Co-Operation and Development (OECD), and beyond.

To be sure, this change was sweeping in the industrialized world, but it was only partially transforming among EMDs. An attempt was also made to change the IMF Articles of Agreement to mandate capital account liberalization in the 1990s. That initiative did not materialize because of contests within the United States, within the IMF, and between the industrialized nations and EMDs. The OECD nations now have a clear mandate for capital account liberalization, but such standards are relatively weak and have significant exceptions.

The Organisation for Economic Co-Operation and Development

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

1. The European Union formalized capital account liberalization in 1988. In this chapter, I focus on global economic governance spanning more than one continent.
That said, the OECD Codes are not very strong in terms of enforceability, and there are fairly broad exceptions in place. Article 7 (in each set of Codes) holds the “clauses of derogation” that govern the temporary suspension of commitments. Under these safeguards, a nation may suspend liberalization. Article 7b allows a member to put in place temporary capital controls to stem what may “result in serious economic disturbance in the Member State concerned, that Member may withdraw those measures.” Article 7c is the balance-of-payments exception: “If the overall balance of payments of a Member develops adversely at a rate and in circumstances, including the state of its monetary reserves, which it considers serious that Member may temporarily suspend the application of measures of liberalisation taken” ( Organisation for Economic Co-Operation and Development [OECD] 2009). Greece, Iceland, Portugal, Spain, and Turkey have all used the derogation. The OECD permitted them to do so because these nations were seen to be at a lower stage of development than the other members of the OECD (Abdelal 2007).

Rethinking Capital Controls at the International Monetary Fund

Beginning in the 1970s, the IMF was transformed as well. What was once at the core of the international monetary system—regulating capital flows to maintain policy autonomy and to stabilize exchange rates—began to be seen as heresy. Initially the transformation was informal, with a shift in IMF staff and management thinking and, thus, a different level of surveillance and different advice to member countries. In the mid-1990s, the IMF proposed to formally amend the Articles of Agreement to include the liberalization of the capital account. According to an IMF staff report, “the impetus for such liberalization was largely provided by the frameworks of the OECD Code and the EU Directives” (Evens and Quirk 1995, 6). This would have amounted to a revision of Article VI, which grants nations the ability to regulate capital flows. This attempt to impose strong international standards at the IMF did not materialize.

As noted earlier in this chapter, under the Articles of Agreement the IMF has no legal authority to force nations to liberalize their capital accounts. That said, the IMF began changing the advice it gave to its member states during the 1970s and 1980s. According to the IMF Independent Evaluation Office, however, the IMF did not require nations to open their capital account as a condition of a financial program. Indeed, the IMF interpretation of the Articles of Agreement is that it cannot “require a member to remove controls on capital movements” (IMF 2005, 31). The IMF did begin, however, to encourage liberalization through letters of intent and policy memorandum that were not part of official financial
program documents. The IMF Exchange and Trade Restrictions Department recommended capital account liberalization in Nigeria, Guatemala, Egypt, Honduras, Jamaica, and elsewhere. What’s more, capital account liberalization figured prominently in the annual IMF World Economic Outlook reports and other publications throughout the 1980s and 1990s. Chwieroth states that “controls were said to harm economic performance, create severe distortions, and delay policy adjustments needed to eliminate balance of payments disequilibria” (2010a, 152). Joseph Joyce and Ilan Noy (2008) econometrically show that such advice was taken—between 1982 and 1998, capital account liberalization was significantly correlated with a nation having an IMF financial program.

Attempts to formalize the new thinking about regulating capital flows at the IMF date back to the early 1970s and were led by the United States. In 1972, the IMF created a Committee of Twenty (C20), and in 1973, a “The Report of the Technical Group on Disequilibrating Capital Flows” was submitted (Pauly 2008). Foreshadowing events in 2011, the “Report of the Technical Group” recommended that the IMF construct a code of conduct for the use of capital controls. The final C20 report that formed the basis for later amendments to the IMF did not include a recommendation to discriminate among kinds of capital control, but US influence steered the report to state that “countries will not use controls over capital transactions for the purpose of maintaining inappropriate exchange rates, or more generally, of avoiding appropriate adjustment action” (quoted in Chwieroth 2010a, 143). The resulting final amendments legalized floating exchange rates, but a consensus on the capital-controls components remained elusive enough that the original Articles, and thus the regime of cooperative decentralization for non-OECD members, remained intact.

Into the 1980s and 1990s, capital account liberalization “had emerged as a social norm” for the IMF (Abdelal 2007, 129). In the early 1990s, the IMF management and staff proposed an official amendment to the IMF Articles of Agreement to codify this norm into strong international standards. According to Rawi Abdelal, the IMF would have rewritten Article VI to state that “Members shall not, without the approval of the Fund, impose restrictions on the making of payments and transfers for capital international transactions” (2006, 189). This was opposed by many EMDs at the Executive Board of the IMF, but the countries lacked the voting power to sway management or other key members of the board. Ultimately, the Asian financial crisis erupted just as the United States was set to renew its funding for the IMF. The US executive director to the IMF and the US Treasury Department had pledged their support for the initiative. But key members of Congress, after extensive lobbying from nongovernmental organizations
(NGOs), threatened to withhold funding for the IMF if the amendments were supported. The Treasury Department withdrew its support, and the amendment was shelved.

The Political Economy of Capital Account Liberalization

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

Revisiting Table 2.1, we see that a confluence of factors integrated to almost cause one of the most decisive shifts in modern global monetary history. US foreign financial power (with the European Union close by) came to dominate global economic politics, given the internationalization of capital markets and the associated political strength that came with an ever-growing global financial sector headquartered in the United States and Europe. In parallel were the new economic theories of capital account liberalization (see chapter 3). Michel Camdessus, the new IMF managing director, strode into the IMF bent on capital account liberalization and found an earnest core of IMF staff members who held the same view. This convergence of power, interests, ideas, and institutional structure gave impetus to forming strong international standards that attempted to replace the regime of cooperative decentralization.

Initially, the prevailing explanation for the change in thinking and policy output at the IMF (and OECD) was the strengthened financial sector and its relations with Washington. Cohen (2007) demonstrates that, although the costs of capital controls are directly felt by a handful of politically organized US constituents (Wall Street), the beneficiaries are diffuse and don’t feel the direct effects. Thus, a collective action problem persisted when Wall Street organized around capital account liberalization. Moreover, whereas in the Bretton Woods era there had been an industry-labor alliance, that alliance had shifted to an alliance between industry and the financial sector (Henning 1994). Voices as diverse as Robert Wade and Frank Veneroso (1998) and Jagdish Bhagwati (2004) called this the Wall Street–Treasury complex (analogous to the military-industrial complex, a term coined during the Eisenhower era to describe the politics of that time). These authors argued that the US Treasury Department and Wall Street investment houses were pushing for the freedom of capital movements wherever possible, including forcing the IMF into advising capital account liberalization.
worldwide and working to codify such a policy in the IMF Articles. Other researchers, such as Kirshner (2003), Mark Blyth (2003), and Manuela Moschella (2011), see interests groups as key in shaping the general change in thinking about capital account liberalization and offer a more nuanced view of the specific role that those powerful interests played in actual IMF policy outputs.

The economics profession had made a profound change in thinking about capital account liberalization. Economic theory went through a fundamental revolution in macroeconomics where Keynesian economics was replaced with new classical macroeconomics. These economists, later joined by the “new” Keynesian economists, saw capital account liberalization as a way to make markets more efficient. Capital controls were seen as not only distortionary but of little use given that consumers and investors would factor them away in their economic decisions. This new thinking in macroeconomics formed the backdrop for a different way of thinking about government altogether—this period is commonly referred to as the neoliberal era, rising with the arrival of Ronald Reagan and Margaret Thatcher in 1979–1980 and cresting with the Washington Consensus advocated by the United States, Europe, and the IMF throughout the 1990s. In general, this era can be characterized as allowing an extremely limited role for the state in economic affairs; the principal role of politics was to carry out the economic view. Mark Blyth (2002) traces the shift from embedded liberalism to neoliberalism in the 1970s:

In sum, just as labor and the state reacted to the collapse of the classical liberal order during the 1930s and 1940s by re-embedding the market, so business reacted against this embedded liberal order during the 1970s and 1980s and sought to “disembed liberalism” once again. In this effort, business and its political allies were quite successful, and by the 1990s a new neoliberal institutional order had been established in many advanced capitalist states with remarkable similarities to the regime discredited in the 1930s. (2002, 6)

Despite the general interest of Washington and Wall Street in this thinking, newer literature on the subject finds that both Washington and Wall Street were conflicted on the issue and that the direct impetus actually came from within the IMF itself. The US executive director to the IMF during the 1990s was Karin Lissakers, who supported the amendment along with the US Treasury Department. Numerous accounts, however, show that the United States was more focused on gaining financial-market access through the trade regime than at the IMF (Abdelal 2007; Chwieroth 2010a). Whereas the IMF could effectively enforce its amendment only on nations that went to it for a financial program, through the WTO (and later US free-trade and investment deals) the United States would
enjoy strong international standards that were actionable by the United States. (This shift of action on capital account issues from the IMF to the trade and investment regime is the subject of a later chapter.)

The financial industry was also less strident in its support for changes at the IMF than was previously surmised, according to researchers who have interviewed high-level officers at the Institute of International Finance (IIF), the broadest collection of global financial firms and institutions. The IIF had shown some early support for the initiative but then called for caution in the wake of the financial crisis. Moreover, and perhaps more important, more than one source confirms that the IIF was tepid about the IMF initiative because the IIF did not want the IMF to move onto its turf of perceived preeminence in the global economic policy realm (Abdelal 2007; Chwieroth 2010a).

Most recent accounts see the origin of the IMF amendment as coming from the IMF itself (Abdelal 2007; Chwieroth 2010a; Moschella 2011). Abdelal (2007) argues that this change was, in part, exported to the IMF from French socialists, who had originally been big advocates of capital controls. Then controls on outflows in 1983 adversely affected the middle class and led to a change in the party stance. When Michel Camdessus (a prominent French socialist at the time) became the IMF managing director, he found highly sympathetic staff members at the IMF and began to work together with them toward the liberalization of capital controls. Chwieroth (2010a) acknowledges that the French connection was important but stresses that the IMF staff members became key advocates as well. In the early days of the IMF, most staff members had been Keynesians who supported capital controls, but slowly the IMF became populated with US-trained economists who were new classical or new Keynesian economists and who saw capital controls as counterproductive. Chwieroth finds, however, that there were tensions between “gradualist” and “big bang” camps at the IMF. Gradualists advocated gradual capital account liberalization and the selective use of capital controls; in contrast, big bang advocates wanted the rapid liberalization of the capital account. The IMF was largely seen as a big bang advocate, especially to casual observers who saw the IMF looking to change its charter to mandate capital account liberalization and to those who observed IMF country programs where capital controls often had to be eliminated as the condition for an IMF loan. Big bang advocates became outnumbered in the wake of the Asian financial crisis and were then silenced by the actions by the US Congress and the voices of EMDs.

EMDs certainly voiced opposition to the proposed amendment, but the countries had neither the unity nor the voting power to significantly affect a policy outcome that would be ultimately in their favor. Aziz Mohammed (1998) and Helleiner (1994) note that many developing countries were extremely skeptical
of the proposed amendment. The G24, a group of finance ministers from EMD nations, said as much in their 1997 communiqué (Mohammed 1998). The head of an independent panel of academics and policymakers from developing countries wrote, “it would certainly seem premature at this time, and, quite possibly, inappropriate for a much longer time, to consider an amendment to the IMF Articles of Agreement that required all members to commit themselves to the achievement of an open capital account” (Helleiner 1994, 33). Such a view was not held by all EMDs, however. Many EMDs had elected political parties and appointed economic policymakers who shared the Washington Consensus view of global economic policy and had been trained in new classical economics (Gallagher 2013).

The Asian financial crisis in 1997 put an end to discussions about changing the IMF Articles of Agreement to include capital account liberalization. Several EMDs had given the IMF supporters stiff resistance from the beginning. Even some industrialized countries, such as Canada, which had just granted Chile the right to regulate the inflow of capital through a newly minted trade treaty between the two nations, withdrew its support for the change (Chwieroth 2010a). There was also a split among IMF staff members on the amendment. Thus, the required 85 percent vote was simply not there. Then the Asian financial crisis came. The crisis was seen by many to be in large part due to a too rapid liberalization of Asian capital accounts, which the IMF referred to as disorderly liberalization. At the same time, numerous economic studies, including the IMF World Economic Outlook, indicated that capital account liberalization was not associated with economic growth (Eichengreen 2004; IMF 2005; Ocampo, Spiegel, Stiglitz 2008). Moreover, many civil society organizations based in Washington began to ally with their EMD counterparts to put pressure on the US Congress to block the initiative (Abdelal 2006; Chwieroth 2010a). When US Representative Richard Gephardt (D-Missouri) got wind of the proposal, his office threatened to withhold US funding for the IMF—right at a time when the IMF was putting together funding programs across the world. That was not the end of the story, just the last chapter of the story of the global governance of capital flows in the twentieth century.

Summary and Conclusion

In this chapter, I have traced the history of governing global capital flows and presented a framework for understanding the first two eras of modern global governance with respect to financial flows. The chapter emphasizes how power,
interests, ideas, and institutions interacted in different combinations to shape each era and to yield different outcomes.

The Bretton Woods era can be characterized as one of cooperative decentralization, during which an order was established that allowed individual nations to regulate cross-border finance on their own and cooperate informally as necessary. That regime worked fairly well, but a confluence of market power, interest-group politics, and new economic ideas led to a push to create strong international standards that would have required the full liberalization of capital flows. That project was partially successful at the national level but failed at the level of global governance. This failure is fairly remarkable considering the consolidation of market and political power that had concentrated in the United States since the demise of the Bretton Woods system, the sea change in mainstream macroeconomics about the economics of capital flows, and the power that the IMF had over EMDs that had experienced over a decade of crises.

Indeed, during the Bretton Woods era, the United States was an internally united hegemon that saw the regulation of capital flows as important to its broader national security and economic interests. The Bretton Woods era was also a period of embedded liberalism, during which nations pursued the integration of goods markets but tempered financial markets in support of national employment and development objectives. Prevailing Keynesian economic ideas supported this view, and the IMF as an institution was codified to preserve cooperative decentralization.

As the cold war ended the United States (and the West in general) was arguably at the crest of its power as a global hegemon. Moreover, the US financial sector had become the true center of global financial power by the 1990s. The economics profession had moved toward a consensus that capital account liberalization was the optimal choice for the global economy. Moreover, the voting structure of the IMF was tilted toward the Western powers. As we might expect, a Wall Street–Treasury alliance arose, proposing an amendment to the IMF Articles that would create strong international standards for capital account liberalization. Indeed, the West had succeeded in revamping the OECD Codes to require capital account liberalization—and had even required disgruntled new entrants, such as South Korea, to sign on to such Codes despite their objection.

Surprisingly, the requirement of capital account liberalization did not happen at the IMF, where the consequences would have been more strongly felt. It was the IMF itself, rather than the United States or the financial sector, that was the originator of the idea of amending the Articles. The United States and the financial sector largely saw the IMF move as an effort to reestablish its waning
global monetary turf and, thus, tempered their support. Within the IMF, there was also significant opposition among the industrialized countries and EMDs alike. Moreover, the IMF staff was divided as well. The US government and the private sector had moved over to the trade and investment arena as a regime—a regime that already had strong international standards. Such a strategy proved to be far more successful for the United States and the financial sector, although a world of full capital account liberalization was still to remain elusive.