

Chapter 2

IFC Studies and the Politics of Finance

The agglomeration and clustering of financial sector activity within cities has resulted in the establishment of the IFC as a subject of research and academic inquiry. IFC studies have also drawn from an existing literature on financial sector development and policy. Policy-makers seeking to develop their cities as financial hubs have long recognized the importance of understanding the nature of financial sector development as well as the financial policies that underpin an IFC's success. A well-established literature on financial sector policy and development provides the analytical tools required for understanding how government policies facilitate or affect IFC development.

Yet, this literature does not adequately take into account contextual and spatial variables, focusing instead on financial policy only at a general level and within the domestic economy. The recognition of these flaws prompted the development of a more specific literature on IFCs that sought to document and understand the rise and success of leading IFCs such as London and New York. Predominantly driven by the work of economists and geographers, these studies contributed to the formation of a specific literature on IFCs that accounts for spatiality and temporality in financial policy. Taken together, the literatures on financial policy and IFCs provide the background information and conceptual knowledge necessary for studying the success of Hong Kong, Singapore and Shanghai as IFCs.

Furthermore, there has been a growing interest in the “politics of finance” among economists and financial experts, with a focus on the influence and implications of politics on financial sector development. However, this emerging strand of research remains at a relatively nascent stage. The remainder of this chapter will provide a critical review of the existing literature on IFCs, financial sector policy and development, as well as emerging studies on the politics of finance. In providing an overview of these literatures, this chapter situates the rest of the book within existing IFC studies and points out the ways in which it contributes to this literature.

Financial Sector Policy and Development

Given the financial sector's role in generating revenues and supporting real economic growth, research and scholarly work on financial policy have long been related to the impact of the financial sector on the real economy. Financial sector development has been shown to be an important driving force for economic growth through what is known as a "finance–growth nexus" (De Gregorio and Guidotti 1995; Jayaratne and Strahan 1996; Levine 1997; Beck et al. 2000; Levine et al. 2000; Rajan and Zingales 2001a; Calderón and Liu 2003; Demirgüç-Kunt and Levine 2008; Zhang and Chen 2013), with financial depth identified as a significant contributing variable to real economic growth (King and Levine 1993). Financial sector development also stimulates growth less directly by boosting manufacturing activities and stimulating trade (Beck 2002). Conversely, real economic growth may also stimulate financial sector expansion via increased savings, suggesting a "reciprocal externality" between the financial and real sectors within an overall process of endogenous growth (Berthelemy and Varoudakis 1996).

Given this important contribution of financial sector development to economic growth, scholarly work in the fields of economics and IPE has largely been focused on understanding how states promote economic growth and competitiveness through financial sector development. However, economists have tended to view financial sector development as a market-driven consequence of burgeoning supply and demand for financial services, while IPE scholars have focused on the active, targeted and often strategic government interventions that drive financial sector development (Cerny 1993a). Nonetheless, economists have since taken a greater interest in the stabilizing role of government interventions in financial markets, especially after the 2008 GFC. This brought a renewed focus on financial policies as both the cause of and potential solution to financial crises (Krugman 2009; Claessens et al. 2010; Stiglitz 2010; Demirgüç-Kunt and Servén 2010; Rötheli 2010; Financial Crisis Inquiry Commission 2011; Rajan 2011; Roubini and Mihm 2011; Peters et al. 2011; Gertler et al. 2012).

However, these studies remained focused on crisis management measures rather than measures geared towards building up and developing new financial markets or sectors. This more developmental focus would be taken up by scholars of IPE, who in the 1990s focused on the role of the state in promulgating policies aimed at financial sector development. This state-centric approach has yielded key theoretical innovations such as the developmental state and competition state models (Cerny 1993a, b; Leftwich 1995; Palan et al. 1996). Other IPE scholars have sought to understand financial sector development in the context of the international system by identifying liberal, realist, pluralist and cognitive models for understanding global finance (Cohen 1996; Dombrowski 1998). However, these IPE studies did not as yet provide a sufficiently clear understanding of the precise measures used by the state to facilitate financial sector development.

This lacuna would be addressed by researchers who focused specifically on the study of financial policies. At the heart of financial sector development is financial

policy. According to Polak, financial policies relate to both the domestic financial structure of the economy and the external financial structure, with the latter including exchange rates, and the rules and institutions that guide capital flows (Polak 1989). Polak reaffirms the “finance–growth nexus” by noting that economic development is the “yardstick by which financial flows and financial policies can be made commensurate” (Polak 1989). This necessitates a strong regulatory role of the state, with government interventions focused on reducing market failure (Stiglitz et al. 1993).

Demirguc-Kunt and Levine have emphasized the importance of financial policies in shaping the “structure and functioning of financial systems” by ensuring political and macroeconomic stability, establishing the legal and information infrastructure necessary for financial transactions to take place as well as a regulatory and supervisory infrastructure that “enables” and empowers markets by encouraging financial market competition, liberalization and access (Demirguc-Kunt and Levine 2008). Similarly, the World Bank’s recent GFDR report emphasizes the role of the state in better aligning private incentives to private interests, establishing sound regulatory and supervisory frameworks, encouraging financial market contestability and competition, promoting transparency of information and strengthening the governance of state-owned banks (The World Bank 2013).

Hellman, Murdock and Stiglitz have also suggested that a set of “financial restraint” policies form the core of government efforts at financial deepening and financial sector development (Hellman et al. 1997). Financial restraint policies aim to create rents in the financial sector through selective government interventions such as deposit rate controls, regulations on entry and restrictions on competition, in the process reducing opportunistic behaviour and inducing efficiency among private market actors (Hellman et al. 1997; Hellman and Murdock 1997). Financial restraint policies also contribute towards the build-up of ‘reputational capital’ among private agents and the development of strong governance mechanisms in financial institutions (Hellman and Murdock 1997).

Of particular importance is the policy instruments that contribute to the management and governance of the financial sector. Seen from this instrumental perspective, financial policy involves seeking the “right balance among policy instruments”, with financial regulation being part of a set of “complementary financial policy instruments” (OECD 2006). Financial policy involves a wide array of government interventions, with financial regulation representing merely one aspect or type of financial policy. This is particularly the case in East Asia, where the state’s role in financial markets has involved creating, regulating and even directing credit to financial institutions, with financial policies serving to both ensure market stability and encourage financial sector growth (Stiglitz et al. 1993). Similarly, Carmichael notes that the public sector participates in the financial sector through its various roles as a regulator of financial institutions, owner of financial institutions, market participant, fiduciary agent and through direct intervention in market operations (Carmichael 2002).

This focus on financial policy instruments has culminated in more recent attempts to provide a typology of financial policy instruments, differentiating

between the following: (i) *market-developing policies* that focus on the long-term building of institutions and infrastructure; (ii) *market-enabling policies* that involve regulatory reforms and encouraging greater competition and (iii) *market-stabilizing policies* such as regulatory oversight and macro-prudential management (Barajas et al. 2013). Much of the existing literature has thus far focused on market-stabilizing policies, with efforts at understanding market-developing and market-enabling policies at a relatively nascent stage.

According to mainstream conceptions of financial policy, the *raison d'être* of financial policy is essentially the maintenance of market stability and the prevention of crises. This *stabilizing* aspect and its inherent objectives of market stability and investor protection remain the most commonly held view of financial policy. Under this view, the “core goals” of financial policy are basically the maintenance of financial system stability and integrity, protection of depositors and investors, as well as ensuring that financial intermediaries perform their fiduciary duties to their clients and shareholders (OECD 2006). Financial regulation is a particularly important stabilizing financial policy that exploits the coercive power of the state to ensure market stability and protect investors (Stigler 1988).

However, this exercise of coercive state power is founded on an “essential faith in capitalism” that precludes direct government intervention in markets (Snider 2011). Rather, financial regulation is focused on establishing the systems and rules that ensure the efficient functioning of markets and prevent the occurrence of any market failure that may arise from market distortions or information asymmetry (Vittas 1991).

However, this commonly accepted stabilizing view of financial policy does not take into account the more active and direct roles of financial policy-makers in financial sector development. Due to distributional concerns inherent in the political process, financial regulation has often been used by governments to achieve objectives that may not be related to market stability and consumer protection, such as protecting domestic financial institutions or “supporting specific industrial or regional policies by channelling funds to particular sectors” (OECD 2006). In conflating financial sector development with industrial policy, financial policy may also be “strategic” or “developmental” in nature (Cerny 1993). Such development-oriented financial policies can further be separated into enabling and developmental policies.

Financial policies can be used to build markets through “*enablement*—the creation not merely of incentives but of those conditions that allow activities to take place” (Baldwin et al. 1998). This often involves the allocation of financial resources to targeted sectors (Haggard and Lee 1993). Enabling policies also allow for the establishment and maintenance of “national comparative advantages”, by constructing conditions and resources that are favourable or necessary for the efficient functioning of financial markets (Arndt et al. 1988; Porter 1998). In such a way, enabling policies can be used to reach economic and social policy objectives by stimulating growth and productivity as well as enhancing competitiveness through “sectoral liberalization” (International Finance Corporation 2010).

Financial policy also plays a *developmental* role in ensuring that the financial system and infrastructure is geared towards the attainment of developmental goals. Such “development-oriented financial regulation” typically involves the allocation of financial resources towards developmental goals or the appropriate investment projects that contribute towards sustainable and equitable economic development (Chang and Grabel 2004; Murinde and Mlambo 2011). Strategies and policy instruments for doing so include influencing bank lending to key sectors, long-term financing by development banks and managing financial firms’ asset holdings through “variable asset-based reserve requirements” (Chang and Grabel 2004).

Such developmental financial policies are therefore used by states in “developmentalist fashion” to favour desired market outcomes (Hira 2006). According to Stiglitz and Uy, financial regulation as a form of development-oriented government intervention contributed to the rapid growth of emerging Asian nations during the “East Asian Miracle” (Stiglitz and Uy 1996). Gordon and Li further note that the Chinese government tends to choose regulations that maximize social welfare objectives and facilitate the collection of revenue from both foreign and domestic investors, by using regulation in place of taxes to extract rents (Gordon and Li 2003).

In short, financial policy comprises three types of policy instruments, namely stabilizing, enabling and developmental instruments. Stabilizing instruments largely include financial regulations that are geared towards ensuring financial sector stability and investor protection; these have traditionally formed the bulk of a financial policy-maker’s toolkit. Enabling instruments are typically used to establish or develop the market conditions necessary for financial institutions to operate and thrive and are closely related to industrial policy. Lastly, developmental instruments refer to financial policies that allow policy-makers to directly channel resources towards financial sectors or markets which in turn contribute to the overall economic development of the IFC. As later chapters will show, stabilizing, enabling and developmental instruments are used in varying extents by financial policy-makers in Hong Kong, Singapore and Shanghai, based on the sociopolitical contexts within which these policy-makers are enmeshed.

However, the existing scholarly work on financial sector policy is limited by its assumption of a unitary monolithic state. Almost all the studies reviewed in this section take the “state” or “government” as the basic unit of analysis and agency. In reality, the formulation and implementation of financial policies are carried out by a wide variety of state and non-state actors. These typically include public agencies at all levels of government as well as industry actors, whether exerting their influence over the financial policy process directly or working through industry associations. Litan et al. (2002) provide a more nuanced approach to understanding financial policy by including the entire “range of institutions and practices by which authority is exercised”, terming such an approach financial sector *governance* rather than policy. This book takes a similar approach by emphasizing financial governance in its totality of policy subsystems and instruments over a narrow focus on financial policy.

However, the largest shortcoming of this existing literature on financial policy is its neglect of spatiality. These studies tend to locate financial policy-making at the national level, with few attempts to situate this understanding at the level of the city or IFC. This is a weakness that permeates both the work of economists and IPE scholars alike. While studies of financial policy by economists have tended to focus on the national government, IPE scholars have tended to focus on the international financial system, similarly taking the state as the basic unit of analysis. In reality, financial policy-making takes place at the level of the IFC, with city or local governments playing a particularly important role. Furthermore, the IFC is itself an intersection between domestic policy-making and international systemic pressures. A small but significant literature on IFCs, driven by scholars of economics and geography, has sought to understand financial policy-making in the context of the IFC. This literature is crucial for the direction which this book has taken.

International Financial Centres

The origins of the IFC literature can be traced back to early studies by economists on financial centres, which were largely based on a desire to understand the emergence of financial centres as centralized locations of financial and economic activity in the 1950s. These studies allowed scholars to establish clear definitions of what a financial centre is and understand the factors which have contributed to the emergence of major successful IFCs such as London and New York. An oft-cited and succinct definition of a financial centre is provided by Kindleberger, who defines a financial centre as “a single worldwide center with the highly specialized functions of lending abroad and serving as a clearinghouse for payments among countries” (Kindleberger 1974). This means that financial centres typically perform “medium-of-exchange” and “interspatial store-of-value” functions (Kindleberger 1974).

According to Reed (1981), a “financial center is an urban area which contains a concentration of specialized institutions that possess, at least marginally, the international skills and capabilities necessary to facilitate the flow of goods, services, information and capital between its own national economy and the other national economies of the world”. Park (1982) provides a more nuanced approach by differentiating between “primary, booking, funding and collecting” financial centres, with each type of centre based on the range and type of international financial transactions that take place within it.

Aside from providing broad general definitions of financial centres, these early IFC scholars also sought to delve deeper into the exact characteristics which make a particular location a financial centre. An important characteristic is the size, liquidity and complexity of financial markets as measured by the number of financial institutions and mobility of capital or funds (Kindleberger 1974; Giddy 1983; Choi et al. 1986; Pagano et al. 1990). Reflecting the international nature of financial centres, a related characteristic is the presence of foreign financial institutions and non-resident market participants (Dufey and Giddy 1978; Choi et al. 1986; O’Brien 1992).

Early scholars also noted the importance of favourable policies that define a location's role as an IFC, with such policies including the maintenance of currency convertibility (Nadler et al. 1955), favourable regulations and taxes (McRae and Cairncross 1973; Choi et al. 1986) and active efforts by the government to attract foreign financial institutions (Johns 1983). Another less direct role of policy is human capital development, with IFCs typically characterized by the presence of skilled financial sector specialists (Nadler et al. 1955; McRae and Cairncross 1973; Kindleberger 1974). These laid the foundation for subsequent efforts to empirically test the validity of such policy and socio-economic factors in contributing to IFC development through the use of quantitative models (Sagaram and Wickramanayake 2012).

Another important aspect of such early scholarly work on IFCs involved identifying and studying the various factors which contribute to the formation of IFCs. According to Kindleberger's "staple theory", the development of banking from its initial roles in serving "sovereigns and nobles" to subsequently serving commerce and government and finally acting as financial intermediaries resulted in the formation of national financial centres which eventually become IFCs (Kindleberger 1974). The concentration of financial activities within IFCs is also explained by the need for face-to-face interaction among market participants, the ability of localization to overcome the costs of information and the dislocation of cross-boundary trades due to time zone differences (Kindleberger 1974).

Goldberg et al. (1988) attribute the development of IFCs to international trade, international financial intermediation and industrial organization factors. The development of these factors stimulates the emergence and growth of a financial services sector, which in turn contributes to the financial market depth and breadth necessary for the development of an IFC. Other more specific factors that have been positively associated with the growth in size of the financial sector include imports, economic development, the number and size of multinational companies present and the significance of the city within the country and time zone, while exports and financial regulation are negatively associated with the financial sector development (Goldberg et al. 1988). The importance of trade in IFC development is underscored by the role that IFCs play in balancing out the surplus and deficits of countries that trade with each other, resulting in the development of an assortment of financial instruments for this very purpose (Economists Advisory Group 1984).

Furthermore, once financial firms within an IFC have achieved external economies of scale and economies of agglomeration, the IFC tends to attain a form of self-perpetuating' growth, even if the initial motivations that had led to the development of the IFC no longer apply (Davis 1990). In other words, a greater number of firms locating to a IFC can result in financial sector growth due to the enlargement of markets, availability of contacts, skilled labour and auxiliary services such as accountants, lawyers and actuaries (Davis 1990). This further led to the view that once IFCs are formed, they show "remarkable powers of survival" in a cumulative process that "concentrate financial markets in a small number of centres" (Economists Advisory Group 1984).

While such early studies have provided definitions of IFC's, delineated the characteristics which qualify a city or location as an IFC and yielded important insights into the factors which have facilitated the emergence of an IFC, they were nonetheless limited by their over-reliance on economics. In particular, these studies focus on quantifiable IFC development variables such as financial market size or the number of financial institutions, which do not reveal much about relations between regulators, financial institutions and other financial sector actors. This means that issues of financial policy actor agency and sociopolitical context were largely under-explored.

As a consequence, these early IFC studies tended to take a passive view of the state in IFC development. According to such early studies, the growth and development of an IFC are typically associated with increased flows of global financial capital and agglomeration of economic activity. The market thus took precedence in these explanations of IFC development. Recognizing this neglect of context, subsequent IFC studies by economic geographers have sought to incorporate spatiality and its inherent sociopolitical assemblages into the study of IFCs. This began with efforts at developing more geographically informed definitions of IFCs, such as Jones' (1992) typology of IFCs as *sub-regional* (involving bilateral trade between the IFC's host country and other economies), *regional* (providing financial services to a specified geographical location) or *global centres* (providing an extensive range of financial services to the whole world). Similarly, Gehrig (2000) defined IFCs as "geographical locations with agglomerations of branches or subsidiaries of banks and other financial intermediaries in narrowly defined regions".

An important theoretical development within this geographically driven study of IFCs is the global cities movement, which studies how a select group of cities tend to dominate the global economy due to their "higher-order functions of control and coordination of economic flows" (Poon 2003). Global cities are therefore "used by global capital as 'basing points' in the spatial organization and articulation of production and markets" (Friedman 2002). While globalization and advances in communications technology have resulted in a "spatial dispersal of economic activities at the metropolitan, national and global level", there is also a "territorial centralization" of management and control over these dispersed economic activities (Sassen 1996).

This centralization means that despite the spatial dispersal of economic activities associated with globalization and technological advancements, global cities continue to serve as sites for the facilitation of global economic transactions by functioning as "command centers in a global economy" (Sassen 1996). Such territorial centralization of global economic activity is in turn associated with two important factors that contribute to IFC formation: national consolidation and market liberalization (Sassen 1999). As such, cities that contain higher concentrations of "major institutional equity holdings" such as banks and investment houses are more likely to become successful IFCs (Sassen 1999). IFC formation and success, according to the global cities literature, is thus based on a simultaneous centralization of financial activities in IFCs and technologically driven dispersal of economic activities globally.

According to Gehrig, this paradox of simultaneous dispersal and centralization of financial activities can be explained by assessing the informational content of financial activities. In particular, IFCs facilitate trade in securities that are “informationally sensitive” and require geographical concentration for communication while securities that are more standardized flow more freely across borders in response to regulatory differences (Gehrig 2000). Information, or access to it, has also been seen as an important factor in determining the functional distribution of roles and services among IFCs (Porteous 1995; Zhao 2013). Such concentration of communication based on the need for information sharing among major market actors results in the formation of an IFC’s “social infrastructure” (Sassen 1999). This growing awareness of such a “social infrastructure” has driven subsequent work by economic geographers who sought to achieve a greater awareness of both the spatial and sociopolitical contexts.

For instance, Clark and Wojcick (2007) argue that global finance is deeply influenced by place-specific financial institutions, with the language of finance serving to culturally and ideologically reinforce state–market–societal relations. This prompted a cultural economy approach that sought to understand how social relations constitute and define financial and economic activities (Clark and Thrift 2005; Hall 2006, 2010). Of particular interest is the role of knowledge networks in connecting financial actors and imbuing their activities with market meanings (Sidaway and Bryson 2002; Lai 2006, 2011). This focus on knowledge networks and the role of socio-technical assemblages in determining the nature of financial practices and subjectivities derives from earlier work by economic geographers on financialization.

This strand of work had sought to understand how financial knowledge production and performativity affect financial market development as well as financial policies (Pryke 1991; Langley 2006, 2009; Pryke and Gay 2007). As a major actor within these networks, states play a crucial role in producing financial subjectivity among its citizens, directing the financial practices of such financialized subjects towards developmental goals (Lai and Tan 2015). Yet at the same time, private sector financial actors are equally able to determine the nature of financial sector development through the diffusion of specific market rationalisms (Carroll and Jarvis 2014), favouring specific locations as investment destinations (Wojcik 2013), or proliferating an increasingly complex array of financial instruments (Christophers 2009).

Through this work on financialization, economic geographers have sought to provide an understanding of how sociopolitical relations and interactions, particularly those involving state and financial elites, influence the development of IFCs as well as the nature of their financial markets and subjects (Aalbers 2008; Hall 2012). This has provided a much-needed focus on the spatial and social context and its impact on IFC development. However, IFC scholars from the public policy and political economy perspectives have been slow to pick up on these insights. This book will draw on this emerging interest in the socio-economic context of IFC development among economic geographers, although it does so from the public policy perspective.

Studies of global cities have also often taken a comparative inter-IFC approach, focusing in particular on the reputational factors and perceptions of IFCs among various financial market participants (GaWC Research Network 2014). This has prompted a more agentic view of IFCs is presented in the work of IFC scholars who sought to study inter-IFC competition. Such efforts have largely been focused on the study of a “hierarchy of international financial centres” and how IFCs compete to reach the upper echelons of this hierarchy (Lee and Schmidt-Marwede 1993; Poon 2003; Poon et al. 2004). Financial policies and regulation have therefore become means through which IFCs may explore and enhance existing comparative advantages in order to gain a competitive edge over other IFCs.

Competition has been seen as an important determinant of IFC development, since it stimulates financial sector growth and encourages greater efficiency and competitiveness among both firms and policy-makers (Choi et al. 2009). Scholars have subsequently sought to study the impacts of history, policy, institutions and geography in determining inter-IFC competition, particularly among emerging Asian IFCs (Jao 2003a; Zhao et al. 2004; Tan and Lim 2007; Ho 2009; Cassis 2010; Jarvis 2011; Lai 2012). However, inter-IFC competition may also foster cooperation among IFCs and contribute to regional integration (Choi et al. 2009). This may arise from a collective desire to avoid costly disadvantageous situations such as bank failures (Cohen 1996). Regardless, global financial integration impacts state–market relations by defining the institutions of production, capitalism and state social welfare at the national level (Dixon 2014).

Mid-level international relations concepts such as the hegemonic stability theory, regime theory, epistemic communities and capital mobility hypothesis have been found to be useful in explaining cooperation among states in global financial markets (Dombrowski 1998). Such complex relations of competition and cooperation have contributed to increased interdependency and a tendency towards “functional specialization” or “differentiation”, particularly among Chinese financial centres such as Hong Kong, Shanghai and Beijing (Lai 2012; Zhao 2013). Inter-IFC cooperation has also been studied in terms of regulatory or policy convergence, particularly among states that wish to reduce the competitive *disadvantages* arising from financial globalization (Lütz 2004).

Subsequent scholarly work has sought to develop a deeper understanding of such competitive or cooperative dynamics among IFCs, placing particular attention on sociopolitical relations or linkages. These include studying how IFCs act as “public–private coalitions” that strategize against other IFCs by relying on locational advantages in financial production (Lee and Schmidt-Marwede 1993) as well as the “strategic alliances” formed among IFCs in a bid to improve the individual comparative advantages (Budd 1995). Inter-IFC relations and competition are also influenced and constituted by “socio-geographical practices” arising from the interaction of financial actors (Pryke and Lee 1995). In particular, interactions between investors, providers of financial services and intermediaries tend to result in an uneven distribution of stock exchanges (and IFCs), hence stimulating inter-IFC competition (Wojcik 2013).

Aside from these studies of major financial centres, studies focused on tax havens have also sought to delve into the international and domestic sociopolitical aspects of financial sector development and policy, particularly in terms of the strategic nature of state financial policy in establishing tax-friendly jurisdictions (Johns 1983; Palan et al. 1996; Palan 1998, 2002; Hudson 2000; Morriss 2010) or the role of tax havens in regulatory cooperation (Eden and Kudrle 2005; Dean 2006). While studies of tax havens provide a more qualitative and contextualized understanding of financial sector development, they remain largely focused on small island economies and hence not able to connect easily with other existing IFC studies.

Despite emerging attempts to provide more qualitative and contextual accounts of IFC development such as the global cities approach and studies on tax havens, there remains a need to focus on the sociopolitical aspects of IFC development. These include exploring the relations among financial sector actors, both state and non-state, *within* IFCs and the impact of such relations on financial policy-making. This means moving beyond existing state-centric and under-conceptualized studies of IFCs (Ng 1998). However, recent work by scholars from the fields of finance, economics and IPE has sought to address this shortcoming by focusing sociopolitical relations in economic and financial policy, showing a deeper appreciation of political processes and relations in financial policy. These are discussed next.

The Politics of Finance

There has of late been an increasing recognition of the influence and implications of sociopolitical variables in financial policy-making. According to an OECD study, financial regulation influences and is at the same time affected by the existing political and social structures in a society as well as the relations between the government, industry and society that form these structures. The rapid globalization and proliferation of financial markets has also made private actors more powerful in their ability to shape and set rules, with the result being an alignment of financial governance with private sector preferences (Underhill and Zhang 2008). This has led scholars to take a more “politically sensitive approach” to understanding financial crisis (Pempel 1999), with one such study focusing on the varying influence which property sector wielded on the Hong Kong and Singapore governments’ response to the AFC (Lim 1999).

This growing clout of politically motivated actors in finance is closely aligned to interest groups and lobbying activities by these groups. In their “interest group theory of financial development”, Rajan and Zingales (2001b) show how private sector influence may hinder financial sector development, especially when powerful industry actors are focused on their narrow self-interests. While this focus on private sector authority in financial and economic policy had previously received attention in the work of key IPE scholars who focused on state–industry relations

and the policy role of industry actors (Strange 1996; Cutler et al. 1999; Haufler 2001; Cutler 2003), this more recent wave of scholarly work on the politics of finance is more focused on domestic politics and the various systemic, institutional and actor-centric drivers of this politicization of finance.

For instance, a state's domestic political system has been seen as an important channel through which inter-actor relations may impact financial policy. Carney (2010) has studied how financial institutions and arrangements are often defined by a priori political contestations between labour, owners of capital and landed interests. More accountable political systems are also positively related to better investor protection and lower costs of entry, thereby stimulating the financial sector development (Perotti and Volpin 2007). Politics also affects corporate ownership in East Asia, with the state becoming a more significant owner of companies over the past few decades and changes in company ownership becoming increasingly dependent upon political change at the national level (Carney and Child 2013).

Scholars have further sought to understand complex inter-actor relations in financial policy through the lens of the policy subsystems approach. While this approach is discussed at greater length in the next chapter, it is necessary to discuss the contributions of subsystem scholars in their studies of sociopolitical relations among financial sector actors. Within the context of US commercial bank regulation, Krause has found that strategic behaviour is prevalent among financial sector actors, who typically engage in a complex mix of cooperative and competitive behaviour in reaction to the behaviour of other actors (Krause 1997). As Worsham (1997) has noted, variations in political arrangements have a significant impact on financial policy subsystems and the policy roles of these subsystems.

Inter-actor relations within a financial policy subsystem also affect how financial sector actors respond to change. Williams (2009) has found that subsystems facilitate endogenous change or policy adjustments in response to exogenous shock, dependent upon the goals and strategies of key actors within the subsystem. However, the dominance of a coalition deeply imbued with a set of strong policy beliefs is also likely to expose a financial system to risk and contagion through "groupthink" and a lack of effective policy coordination (Gieve and Provost 2012). More recently, Woo (2015a, b) has shown how the strength of "policy relations" between state and non-state actors facilitates the "co-creation" of financial policies, particularly in Asian IFCs.

Studies that seek to understand inter-actor relations in the financial sector have also taken on an international approach, focusing on relations between financial sector actors across national boundaries. For instance, scholars have found that regulators and other state actors are increasingly connected to their foreign counterparts, often operating within transnational networks of regulators and central bankers (Kapstein 1992; Cerny 1993b). This increasing recognition of inter-actor relations in global financial markets has resulted in the emergence of a network approach to studying global financial markets. Specifically, Oatley et al. argue from an IPE standpoint that the international financial system has become a system of economic and political relationships between public and private actors (Oatley et al.

2013). Similar efforts can be found in Knoke's work on "economic networks", which takes a more sociological approach to understanding social relations and social capital in the global economic system (Knoke 2012).

While this growing interest in the politics of finance has brought forth useful new insights into the sociopolitical basis of financial sector policy, there remain several issues that have yet to be addressed. First, a vast majority of these studies are based on the context of developed Western economies. Given differences in political systems and state–industry relations between these developed Western economies and emerging Asian economies, there is a need for more extensive research into the political-economic context within which Asian financial policy-makers and regulators operate. Furthermore, existing studies do not sufficiently delineate the precise means or mechanisms through which different combinations of financial policy actors, state or non-state, are involved in financial policy-making. There is thus a need to further explore and explicate politics–policy or subsystem–instruments linkages. This book attempts to achieve these.

Conclusion

This chapter has provided a comprehensive review of the literatures on financial policy and IFCs. Both literatures have made significant contributions to the study of financial sector development. In particular, the financial policy literature has provided a systematic description of the means and mechanisms through which governments are able to develop and regulate financial markets. The IFC literature has further built on this by studying financial policy through a more international systemic lens. This has allowed IFC scholars to identify the factors and processes which have contributed to IFC success. More importantly, these scholars have shifted the study of financial policy to the city or local level of government.

However, these two bodies of work remain insufficient in addressing several key questions that this book will seek to address. First, while the financial policy literature describes ways in which governments have managed to achieve financial sector development, it does not sufficiently address the issues of context and spatiality. Rather, financial policy-making is assumed to take place at the national level, with the state taken as a unitary monolithic financial policymaking unit. In reality, the bulk of financial policy-making is carried out by local or city governments who actually run the IFCs.

While the IFC literature addresses some of these shortcomings by situating financial policy processes spatially and temporally within the globally connected IFC, it does not sufficiently account for the political-economic context within which IFCs exist or the sociopolitical relations which connect policy-makers and other significant financial sector actors. Instead, much of the IFC literature focuses on structural and locational factors contributing to IFC success and overemphasizes a convergence of IFC development models based on these factors. While qualitative

IFC studies on tax havens and global cities have sought to overcome the limitations of such quantitative approaches, these studies have yet to adequately delineate and provide a clearer understanding of the sociopolitical relations which underpin IFC development.

In response to these limitations, scholars have begun to address these shortcomings by taking a network or subsystems approach to studying financial policy and focusing on the “politics of finance”. However, these studies remain at a rudimentary stage and are unable to provide a sufficiently clear or in-depth understanding of how such inter-actor relations affect financial policy-making and contribute to IFC success. In other words, the politics–policy linkage in finance is insufficiently explored. Furthermore, the Western-centric nature of these studies raises questions over their applicability to the study of Asian IFCs which operate within markedly different political systems.

These shortcomings in the financial policy and IFC literatures point towards a need to reconceptualize the existing understandings of IFC development. In particular, two clear issues need to be addressed. First, there is a need to develop a comprehensive understanding of the exact means or policies through which governments drive or stimulate IFC development. Second, there is a need to situate these policies within the milieu of the political-economic context. These two areas will be addressed in the remainder of this book. However, this book does not propose to address these issues completely. Rather, it merely constitutes useful first step towards addressing some of these issues and providing a more conceptualized understanding of the politics of finance in Asia.

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