Understanding the Financial Stability Board: A Critical Juncture in Financial Regime Formation

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Undergraduate Honors Thesis

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Outline of Content:

Special Thanks

To my parents and grandparents for their unconditional love and support;
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I. ABSTRACT

In the wake of the 2007-2009 economic crisis, the world has seen a resurgent push for global financial governance. The international policy community is no stranger to movements for greater economic coordination. Traditionally, the Bretton Woods institutions, the G-20, and the Basel Committee on Banking Supervision have served as primary venues to facilitate such state-level cooperation. Now, policymakers and scholars alike focus attention on the Financial Stability Board (FSB), the newest body chartered to coordinate global financial regulation. While policymakers assess the Board's potential impact in the short and long term, the scholarly community seeks to understand how the Board fits in with existing patterns of financial regime formation. These researchers promote competing frameworks to explain how structures for global governance develop. Such models fall into two main schools of thought: the power-based perspective and the institutionalist approach. While power-based theories suggest that relative power considerations drive policy outcomes, the institutionalist school demonstrates how a broader conception of the national interest can foster cooperation through institutions. In a February 2010 working paper, Nilima Gulrajani suggests that these two frameworks are not mutually exclusive. This research builds upon Gulrajani's thinking by exploring the main components of these competing frameworks. A single-in depth case study of the FSB illustrates both how these frameworks interact in the same policy space and how their relative explanatory power has evolved over time. Although the power-based approach explains how changing power dynamics impact patterns of cooperation, the establishment of the FSB marks distinctive shift toward the institutionalist perspective as a more relevant model of regime development. Ultimately, this finding highlights a change in the underlying policy environment to one

distinguished by a broader conception of the national interest. Yet the durability of this transition remains uncertain as memories of economic crisis fade.

II. INTRODUCTION

The 2007-2009 meltdown of the American economy resulted in widespread financial contagion that touched both developed and developing economies across the world. The depth and breadth of this contagion immediately served as the exigency for a new movement toward greater international financial regulation. Yet experience tells policymakers that even in the aftermath of a major crisis, establishing new global regulatory regimes can prove a daunting task.

Historically, a variety of institutions have played a major role in facilitating policy formation. The Bretton Woods Institutions- the World Bank, the International Monetary Fund (IMF), and the General Agreement on Tariffs and Trade (GATT)- represent the original children of catastrophe born in the aftermath of World War II and the Great Depression. Additional financial institutions, including the G-20, the Basel Committee on Banking Supervision, and the new Financial Stability Board, currently play key positions in coordinating international economic policy. What processes ultimately lead to the development of financial regulatory bodies?

A variety of researchers have developed competing theories to explain how global financial regimes form. As Stephen Krasner defines them, international regimes are “principles, norms, rules, and decision-making procedures around which actor expectations converge in a given issue-area” (Krasner 1). Theories that describe how such institutions develop tend to fall into two main bodies of scholarship: the power-based school and the institutionalist paradigm. Daniel Drezner represents a leading voice of the power-based theorists. Drezner describes regime formation as a coordination game, emphasizing the importance of power differentials between developed and developing economies. These disparities, combined with a highly individualized view of the national interest, lead to forum shopping by the status quo powers. These powers can opt into regulatory "clubs" with fewer members, limited enforcement mechanisms, and rules aligned with their own national interests. On the other hand, institutionalist scholars led by Martha Finnemore borrow from the language of sociology to describe regime formation in terms of cultural norms. As states begin to compromise and to embrace a broader conception of the national interest, shared values lead states to participate in more open institutions. Although these perspectives appear incompatible, a recent working paper by Nilima Gulrajani begins to demonstrate how these frameworks can work together and operate within the same space.

Ultimately, this research explores both the power-based and institutionalist schools in order to better understand the main tenets of each framework. A single in-depth case study reveals the establishment of the FSB as a key turning point in financial regime formation. Although the power-based approach retains value in explaining how changing power differentials impact cooperation patterns, the FSB signifies a remarkable shift toward the institutionalist framework an increasingly relevant theory for contemporary regime development. Overall, this research contributes to the current discussion of the FSB by highlighting both the increased value of the institutionalist paradigm and the corresponding changes to the world order that enabled this transition.

This analysis begins with an historical review of the international economic system and the development of related institutions. Next, it provides a close examination of the power-based and institutionalist perspectives, along with Gulrajani's reconciliation of the two theories. After evaluating the weaknesses of Gulrajani's approach and articulating a methodology for evaluating each theory's relative explanatory power, this research delves into a single in-depth case study of the FSB to test the resulting hypotheses. Finally, the conclusion explains the factors impacting each theory's relevance, identifies the resulting policy implications, and frames questions for future exploration.

III. RESEARCH QUESTIONS

General:

- How do regulatory regimes for global financial governance develop?

Specific:

- What are the competing explanatory merits of the power-based and institutionalist conceptions of regime formation? Can these frameworks be combined to generate a more inclusive, encompassing explanation of institutional development?
- Has the relationship between the power-based and institutionalist theories changed over time?
- What will a single in-depth case study of the FSB reveal about how these schools of thought operate together?

IV. PERSPECTIVES ON FINANCIAL REGIME DEVELOPMENT

A History of International Financial Institutions

The 2008 financial crisis has inspired the return of attention to issues of international economic governance and financial regulation. This reemerging interest represents a renewal of early emphasis on international financial institutions (IFIs). From 1870 until the dawn of World

War I, international finance operated according to the gold standard. In other words, national currencies derived their value from gold backing, and governments used macroeconomic policy to maintain these exchange rates (Armijo 380). After World War I, uncertainty permeated international finance. In the 1920s, protectionism dominated as the most prominent policy theory, leading countries to turn inward and to limit their external cooperation. This absence of collaboration on economic policy contributed to the Great Depression of the 1930s. This period featured a variety of competitive actions, including exchange rate devaluation and the formation of adversarial monetary blocs, that contributed to continued economic deterioration (Spero and Hart 14).

1944 represented a critical juncture for international financial governance. Policymakers of the World War II era founded the Bretton Woods System of fixed but adjustable exchange rates coupled with the U.S. dollar as the system's reserve currency backed by gold. This system also resulted in the development of three key institutions: the IMF, World Bank, and the GATT (Spero and Hart 2). While the IMF aimed to promote long-term economic stability through exchange rate and crisis management, the World Bank assumed the mandate of reconstruction in the aftermath of war (Armijo 381). The GATT, designed to increase international trade, has since become the World Trade Organization (WTO) with a broader scope and stronger enforcement powers (Spero and Hart 10). Although the contemporary policy environment continues to evolve, the IMF, the World Bank, and the WTO remain some of the most influential bodies in operation today.

According to Spero and Hart, superpower management of the global economy characterized this period from WWII through 1971 (10). Since the Soviet Union looked within itself for economic development according to quasi-communist principles, the United States filled a vacuum as the dominant power of the global economy. European and Japanese encouragement supported the United States in emerging as an economic hegemon (Spero and Hart 4). This situation additionally served security objectives by helping the United States to accrue power relative to the Soviet Union, which was of particular strategic importance in a zero-sum environment. Further, in the aftermath of WWII, the United States stood as the single healthy economy among the status quo powers. Despite limited international economic data for the pre-1970 period, GDP per capita figures (measured in U.S. dollars) shed some light on this disparity. As Figure 1 below demonstrates, in the post-war years from 1950-1971 (data for 1945-1949 unavailable), U.S. GDP per capita far exceeded the respective figures for the United Kingdom and Japan. These data illustrate two key points. First, WWII did not have the same negative economic impact for the United States as it did for the United Kingdom and Japan. Second, the U.S. economy continued to grow while the British and Japanese economies began to recover from wartime devastation. Thus, in the post-WWII period, the United States found itself in a position of sheer economic supremacy compared to the other key powers.

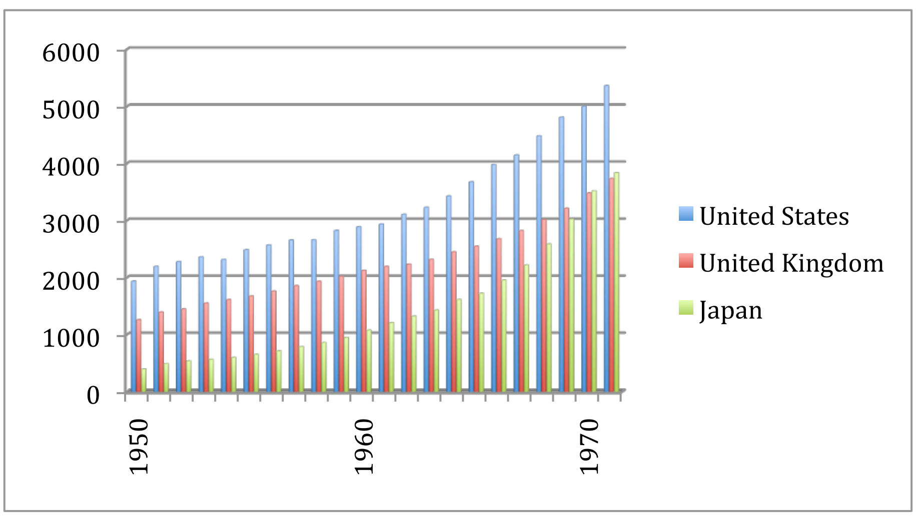

Figure 1: GDP per capita in millions of dollars for the United States, the United Kingdom, and Japan: 1950-1971 Graph created by Ryan Ingram. Data from PWT 6.3. Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 6.3, Center for International Comparisons of Production, Income and Prices at the University of Pennsylvania, August 2009.

Finally, in reaction to its experience with the Great Depression, the United States aimed to facilitate global interaction. Given that the depression resulted in large part from protectionist policies, the United States engaged heavily in economic liberalization to prevent future crises with the same roots (Spero and Hart 3). As it assumed its role as economic superpower, the United States took key actions to facilitate long-run economic adjustment for Europe and Japan. In large part, the United States took this policy stance because it could afford such economic concessions. While providing liquidity for the international system, the United States also supplied economic aid to compensate for large trade imbalances and deficits. In the case of Japan, the United States even accepted trade protections against U.S. exports but continued to import large quantities of Japanese products. Ultimately, these U.S. actions fostered the long-term economic competitiveness of both Europe and Japan (Spero and Hart 17). Despite this apparent movement toward liberalization, tariffs, quotas, and exchange controls still limited the movement of goods and capital across borders (Spero and Hart 2).

The period from 1971 through 1989 signifies an era of collective economic management (Spero and Hart 10). As new technological developments increased the volume of trade and capital flows, global liberalization faced new challenges in the form of both non-trade barriers and regional economic agreements (Spero and Hart 5). Further, during this period Europe and Japan experienced tremendous economic growth, leading them to question the validity of U.S. economic control (Spero and Hart 7). In particular, the Nixon Shock of 1971 resulted in a strong push for the diffusion of economic power among a variety of international actors. For years, the United States had maintained a policy of "benign neglect," remaining inactive as inflation increased and currency crises jarred the international system. Yet on August 15, 1971, Nixon took sudden, unilateral action, announcing the end of the dollar's convertibility into gold.

Nixon's imposition of this decision on the entire international system generated outrage and extreme distaste for U.S. economic control (Spero and Hart 24). Although the nations that now form the G-10 sprang into action to renegotiate the international monetary system, by 1973, all major world currencies converted to a float (Spero and Hart 25).[1]

Simultaneously, U.S. power diminished due to its own debt burdens in terms of both fiscal spending and balance of payments. Further, in the period from 1973 to 1974, the United States experienced the first of a series of oil shocks that contributed significantly to mounting stagflation (Hunt 5). Although scholars offer competing explanations for this sudden series of price increases, which quadrupled the price of oil over a one-year period, the most prominent perspective attests that the Organization of the Petroleum Exporting Countries (OPEC) operated as a cartel to artificially inflate prices by limiting oil production (Gately 1101). As OPEC claimed, this action served as a response to the Yom Kippur War and the presence of Israeli troops in historically Palestinian territories (Hamilton 220). The U.S. public criticized the State Department for what the public perceived as the bureau's failure to stand up against OPEC (Gately 1101). Ultimately, this particular crisis and its severe economic impact offered evidence of the international system's difficulty with effective macroeconomic management.

In addition to reform of the Bretton Woods institutions, this period also saw the establishment of the G-5 and its expansion to the G-7 (Spero and Hart 7). Founded in 1973 by George Shultz, this group of leading economic powers initially included only five countries: the United States, France, Germany, Japan, and the United Kingdom (The Wall Street Journal). The expansion of this cooperative arrangement to seven nations, including Canada and Italy, signaled

[1] The G-10 denotes the group of countries that initially agreed to support the IMF's General Arrangements to Borrow (GAB) by donating resources to be available to both participants and occasionally nonparticipants. This group also directed discussions culminating in the 1971 Smithsonian Agreement to restructure the international monetary system (The International Monetary Fund).

a trend toward greater inclusion, as well as a continued commitment to economic liberalization (Spero and Hart 7). Overall, this period led to the diffusion of economic power and the perpetuation of policies promoting economic integration (Spero and Hart 6).

Spero and Hart denote the final period of economic history ranging from 1989 to the present as one of globalization marked by increasing levels of global economic governance (10). With the end of the Cold War, capitalism and its main tenets- deregulation, privatization, and liberalization- took root. With this shift toward increasingly capitalist practices and principles, the volatility of trade and capital flows increased, illuminating the issues of interest and exchange rate politics. After the fall of the Soviet Union, the United States emerged as the only remaining political superpower able to influence global economic principles (Spero and Hart 8). In this context, regional bodies such as the European Union (EU) and the Association of Southeast Asian Nations (ASEAN) facilitated liberalization and economic integration (Spero and Hart 9). This period extending through the present reflects the influence of globalization on international economic interaction.

However, it remains to be seen whether the 2007-2009 global financial crisis marks the dawn of a new period characterized by its own norms, trends, and institutions. Although the recent emergence of the FSB seems to signal a continued commitment to international economic integration, it will be some time before policymakers and researchers can assess how efforts for coordinated financial regulation impact economic stability.

Policy Developments of the Globalization Period: Providing Evidence of Increased Convergence

The rise of several contemporary institutions exemplifies this trend toward increased integration. For example, the G-20, the Basel Committee on Banking Supervision, and the WTO represent recently formed institutions to coordinate cooperation on economic regulation. The G-20 is the most recent iteration of the G-5. Rather than just five, seven, or ten established economic powers, the expanded institution includes representatives of several developing economies. In December 1999, the G-20 first met in response to the Asian and Russian financial crises. As it has grown more inclusive, the group continues to play a key role in coordinating an international response to the recent financial crisis (The Wall Street Journal).

Although originally established in 1974 during Spero and Hart's period of interdependence, the Basel Committee's most influential contributions to financial regulation appeared in this most recent period of globalization. Founded by the G-10 central bank Governors, the Basel Committee meets several times a year and allows nations to share information concerning the best practices for financial regulation. Additionally, the venue offers members the opportunity to develop universal standards for compliance (Basel Committee on Banking Supervision 1). Basel II, negotiated in June 2004, represents one of the body's most well recognized policies. The agreement includes three main pillars that constrain banking activity in order to mitigate risk. Pillar I establishes mandatory capital requirements for banks, allowing managers significant leeway to assess their reserve needs based on respective risk portfolios. Meanwhile, Pillar II encourages banks to establish their own risk management practices, while Pillar III recommends disclosure requirements (Seabrooke and Tsingou 21). Ultimately, these policy reforms reflect a developing interest in systemic risk reduction, resulting from experience with the increased capital volatility in this period of globalization.

Finally, born in 1995 from the General Agreement on Tariffs and Trade (GATT), the WTO provides an international forum for the negotiation of trade agreements, a set of contracts to govern this commerce, and a dispute resolution mechanism for settling conflicts between member nations (World Trade Organization 9-10). Once again, the strengthening of the GATT to generate a new institution with broader powers and a wider mandate reflects a need for heightened global governance amid increasing transnational flows of capital and goods (Spero and Hart 10). Overall, the number and breadth of institutions established in the last 20 years reflects the influence of globalization on international economic interaction.

Crises of the Late 1990s: Revealing Weaknesses of the International System

The 1980s and 1990s saw the creation of a multiplicity of new financial institutions aimed to increase regulatory coordination at the international level. The International Organization of Securities Commissions (IOSCO), the International Association of Insurance Providers (IAIS), and the Committee on Payment and Settlement Systems (CPSS) all emerged in the 1983-1994 period (Helleiner, Pagliari et al. 2). Yet the existence of these various organizations did not safeguard against the Asian crisis of the late 1990s.

The 1997 Asian crisis led policymakers and researchers to evaluate the state of international financial regulation. Key criticisms included the lack of oversight for corporate governance, accounting, and auditing. Critics also began to question the validity of the Washington Consensus. As John Williamson and early supporters of the approach describe it, the Washington Consensus articulates a set of prescriptions for economic development including the transition to a market economy, trade liberalization, and macroeconomic discipline (Serra et al. 3). Yet these critics highlighted the approach's failure to articulate the necessity of financial regulation to compensate for increased market volatility (Serra et al. 6). In response to this call for regulatory architecture, the OECD issued a draft statement of recommendations for corporate governance best practices, and the International Standards Accounting Board (ISAB) created a set of International Financial Reporting Standards (IFRS) (Helleiner, Pagliari et al. 2). Further, the G-7 promoted the International Auditing and Assurance Standards Board (IAASB) as an additional private sector actor to motor regulatory adherence (Helleiner, Pagliari et al. 3).

However, a variety of concerns about international financial regulation remained. First, as evidenced by the sheer number of institutions with oversight roles, financial regulation remained highly fragmented. Although the Financial Stability Forum (FSF) and the Bank for International Settlements (BIS) emerged to coordinate the efforts of more specialized bodies, the disorganization of the standard-setting process continued to pose considerable challenges (Helleiner, Pagliari et al. 3). Further, the Asian crisis illuminated another key difficulty: the lack of enforcement power for financial institutions. Unlike the WTO, which can arbitrate disputes and enforce rulings, existing financial advisory boards only had the power to suggest best practices for regulation (Helleiner, Pagliari et al. 3). Finally, it became clear that membership to these organizations was highly exclusive, thereby limiting the global character of agreements. For these organizations, the G-7 served as the basic membership body with the possible addition of a few other nations. For example, the CPSS included the G-7, Belgium, the Netherlands, Singapore, Hong Kong, Sweden, and Switzerland (Helleiner, Pagliari et al. 4). Clearly, this group excluded a large number of significant emerging economies. All together, the experience of the financial crises of the late 1990s revealed pressing issues related to institutional fragmentation, enforcement, and inclusion.

Theories of Financial Regime Development

Given this resurgence of general interest in international financial standards and institutions, there remains some uncertainty about how these regimes develop. There exists an expansive collection of literature tackling the subject of regime theory, particularly in relation to global financial governance. Seminal works by Robert Keohane, Robert Putnam, and James Fearon provide the initial groundwork for discussions of regime formation, international cooperation, and bargaining (Keohane 345, Putnam 11, Fearon 270). Together, these theories reflect how the study of regime development has progressed over time.

However, the literature has since diverged into two main bodies: works focusing on the implications of power dynamics and research employing a institutionalist perspective. Drezner and Finnemore stand as the respective leaders of these disciplines. Ultimately, the work of Gulrajani aims to reconcile these perspectives into a holistic vision of how financial regimes develop. This section will introduce the works of Keohane, Putnam, and Fearon to outline the historical roots of these theories. Next, it will describe the respective tenets of the power-based and institutionalist schools, focusing on the works of Drezner and Finnemore but also drawing from the perspectives of additional authors. Finally, this section will elaborate Gulrajani's argument and process in order to inform an understanding of her methodology and purpose.

The Foundations of Regime Theory

The work of Robert Keohane represents a groundbreaking contribution to the dialogue on institutional development. According to Keohane, institutions work by facilitating agreement among nations, thereby allowing them to overcome common collective action problems. Like other public goods, institutions tend to be underprovided. However, an increase in the number of related issues within a specific policy space and an increase in regime effectiveness can both stimulate demand for institutions (Keohane 354). In turn, these organizational structures reduce transaction costs and mitigate uncertainty (Keohane 339, 351). In short, institutions develop in response to demand. Such demand crystallizes when consolidated negotiation can reduce transaction costs and when repeated interaction within an established framework can reduce uncertainty.

Another compelling model for understanding international cooperation is the two-level game model of Robert Putnam. According to Putnam, bargaining among negotiators is best conceptualized on two separate levels of interaction. On Level I, negotiators bargain among themselves to determine a tentative agreement. After establishing this agreement, the negotiators must present the terms to their respective constituencies (Level II) for approval (Putnam 11). This basic framework clarifies how regulatory standards form because it reveals the role of domestic considerations in the establishment of international agreements. The preferences of constituents tie the hands of negotiators and provide constraints that limit possibilities for compromise. This idea of the relationship between domestic constituents and government actors also plays an important role in the specific literature relating to financial governance regimes.

Author James Fearon introduces yet another key element to the debate. Fearon argues that the process of establishing international cooperation can be understood as two separate phases: bargaining and enforcement. While the bargaining aspect mirrors Putnam's explanation, the enforcement portion draws on a common game theory model, the Prisoner's Dilemma, to conceptualize the role of defection in international agreements. Fearon concludes that international cooperation on all issues follows this basic structure and that information about the possibility of enforcement tends to affect the bargaining process (Fearon 270). This distinction between bargaining and enforcement is key to understanding the literature on the development of regulatory regimes, which draws heavily on game theory to model the obstacles of cooperation. Overall, these models serve as a valuable introduction to contemporary regime theory.

The Power-Based Theory of Regime Development

The power-based rationale captured in Drezner's work serves as an extension of these game theoretic models. Drezner conceptualizes regulatory bargaining in terms of a two-by-two game. In this context, power (defined in terms of "internal market size and vulnerability to external shocks) generates payoff asymmetries that affect the outcome of negotiation (See Appendix A, Figures 2 and 3). The Great Powers—the United States and the European Union (EU)—can compel less powerful states by manipulating the incentive structure. According to this model, nations will cooperate as long as the costs of adjusting domestic policies do not exceed the benefits of cooperation (Drezner *All Politics* 58-59).

Perhaps the most important contribution of this perspective is its focus on power asymmetries. These differentials offer a critical implication: a Great Power can leverage its standing to pressure less powerful countries into accepting suboptimum outcomes. Additionally, Drezner highlights the domestic and international considerations for state actors. When making decisions at the international level, policymakers consider the preferences of domestic constituents and incorporate these in their assessment of internal adjustment costs. For example, if membership to an emerging regulatory body requires a country to create a domestic agency to gather economic data, and policymakers face a tradeoff between establishing this agency and providing social programs preferred by the public, then the policymakers potentially face a more severe adjustment cost upon joining the organization. As Drezner suggests in his focus on power asymmetries, the adjustment costs for less developed economies frequently exceed those of the most sophisticated economies.

In addition to these basic power asymmetries among states, the level of cooperation among Great Powers can serve as a key signal of potential policy convergence. If the Great

Powers can generate a consensus, then there will be a high level of policy convergence in a globalized environment. However, if these state actors cannot agree, then harmonization of policy will occur to a lower degree. Great Powers in opposition compete for allies in order to generate returns to scale on collaboration. Thus, the sort of convergence that occurs will appear to a lesser extent than in the context of Great Power consensus (Drezner “Globalization” 842).

Finally, Drezner also offers some particular caveats that apply to the realm of international finance. In particular, he focuses on the division of preferences among powers. While the United States and the European Union, both advanced economies, tend to favor stricter regulations due to relatively small adjustment costs, developing economies demonstrate a different set of preferences due to higher costs and more uncertain perceived benefits. For example, while the Great Powers with high per capita income will achieve significant gains through coordination on strict regulatory measures, it is often less clear how such cooperation will impact the payoffs for countries with weaker financial industries. Thus, the short-term costs of cooperation can exceed the perceived gains for developing economies. These divergent preferences result in “forum shopping” by the Great Powers (Drezner *All Politics* 122). Ultimately, these governments can choose to work outside of International Financial Institutions (IFIs) and to establish regulatory clubs, such as the Financial Stability Forum, or establish informal clubs within the IFIs (Drezner *All Politics* 147). This addendum in regard to the particular situation of financial governance represents an important contribution to the current discussion because it highlights the willingness of the Great Powers, and by implication other developed economies, to seek regulatory solutions outside traditional IFIs. This notion can inform the understanding of current regulatory development in the wake of the current economic crisis.

Ethan Kapstein promotes a similar perspective on global financial regulation. According to this author, international cooperation takes the form of a two-level game. State actors must negotiate policy on an international level, but they must also consider the domestic constraints that limit the possible range of agreement (Kapstein *Governing* 2). States face the additional constraint of their relative size and power in the international system (Kapstein *Governing* 10). Opportunistic states can leverage a favorable power differential to impose policies on less established economies.

With globalization, these domestic and power-based constraints have become increasingly stringent based on considerations of relative gains (Kapstein *Governing* 11-12). In other words, states face a dual challenge that results from a mixture of "product and purpose" (Kapstein "Architects" 3); states must cope with their relative position due to power asymmetries within the international system, but they must also address domestic preferences for general economic stability and policies that benefit local firms (Kapstein "Architects" 3). In response, states have adopted a model of "international cooperation based on home country control" in which the primary mechanism of international agreement is consensus among states. As seen with the EU and the concept of mutual recognition, consensus allows states to maintain responsibility for regulating their own national institutions through self-selected standards (Kapstein *Governing* 9). When consensus fails, each state often pursues its own domestic agenda, leading to collective action failure as modeled by the Prisoner's Dilemma (Kapstein "Architects" 3). Ultimately, this language of two-levels games combined with power dynamics in the context of globalization echoes the language of Drezner.

Overall, the works of Drezner and Kapstein highlight key aspects of the power-based theory. Both authors model negotiation on international financial regimes according to an established game theory-based approach. Specifically, this model takes the form of a two-level game, as seen with Putnam, in which negotiation occurs at the international level, but state actors must consider the domestic preferences that constrain the zone of possible agreement. Once again, both authors reach a key point of agreement: the complex role of power differentials between state negotiators. In particular, Drezner highlights the telling nature of power differences between developed and developing economies. When these power differentials result in divergent preferences, two possibilities arise. In the absence of consensus, Great Powers may resort to forum shopping and look to a club organization to establish regulatory standards (Drezner *All Politics* 122). Alternatively, as Kapstein suggests, a lack of international agreement with home country control can result in collective action failure (Kapstein "Architects" 3). These predictions illustrate how the key elements of the power-based framework should operate in practice.

The Institutionalist Theory of Regime Development

In contrast to this vision of a power-based struggle for regime formation, the institutionalist perspective focuses on the development of institutions as an extension of norms and culture. Martha Finnemore draws on organization theory, a body of scholarship in the field of sociology, to explain the connection between culture and institutions. As organization theory specifies, the specific cultural norms that tend to be perpetuated globally are Western concepts. In particular, rationality as a universal decision-making principle affects the development of contemporary institutions (Finnemore 325, Drori et al. 26). When a cultural norm, such as the use of rationality as a decision process, becomes globally accepted, it can also be said to have become an international institution. Ultimately, Finnemore underscores that the diffusion of cultural norms leads to the creation of new global institutions from a systems-based perspective (Finnemore 326).

Additional authors contribute to this discussion that applies concepts from sociology to an analysis of regime formation. For example, H. Jorgens emphasizes the cross-national diffusion of norms as a process by which international standards converge. As governments learn by imitating and emulating each other, certain standards emerge that define appropriate behavior in the international system (Jorgens 7). In order to avoid both the political and economic costs of divergence, governments respond to peer pressure and accept the new standard. As this diffusion occurs, a standard becomes a cultural norm and behavior constraint (Jorgens 8). Ann Florini also employs this language of norms but uses scientific vocabulary to describe the diffusion process. Just as in a biological evolutionary process with competition among genes, there exists a competition among norms for international behavior. The same way genes are transmitted through inheritance, norms are passed culturally from one group to the next (Florini 387).

Further, Leonardo Martinez-Diaz and Ngaire Woods define club IGOs, like the G-20, as networks (4). According to the authors, a network is a "non-hierarchal governance structure in which relations among actors are repeated and enduring, but where no one has the power to arbitrate and resolve disputes among the members" (Martinez-Diaz and Woods 1). These informal structures have the power to perpetuate norms and to facilitate diffusion by offering a venue where state actors can deliberate these cultural standards. Ultimately, peer pressure and knowledge sharing serve as mechanisms to transfer norms between actors (Martinez-Diaz and Woods 9). Eric Helleiner furthers this argument about networks by linking Peter Haas's concept of epistemic communities to the transnational relationship among central bankers (Helleiner 199). With similar educational and professional backgrounds, central bankers tend to share a similar mindset and approach—what Haas terms a "common conceptual framework"—that allows them to achieve consensus based on accepted principles (Helleiner 200). Once again, the culture of an epistemic community, in this case the group of central bankers, plays a key role in generating cooperation on regulatory policy. This discussion of the influence of norms and culture on institutional development provides a compelling contrast to the power-based approach.

Overall, these authors focus on several main themes. First, Finnemore, Jorgens, Martinez-Diaz, and Woods all highlight the concept of global diffusion as the process by which cultural norms are transmitted internationally. Further, Martinez-Diaz, Woods, and Helleiner all underscore the roles of peer pressure and knowledge sharing in the consensus-building process. These broad concepts generate specific predictions that help to identify the operation of these processes. According to Finnemore, when a cultural norm experiences global diffusion, the accepted standard becomes a new international institution (Finnemore 326). Additionally, Martinez-Diaz and Woods predict that club IGOs will facilitate diffusion by encouraging deliberation and by providing a structured environment in which peer pressure and knowledge sharing can occur (Martinez-Diaz and Woods 9). Ultimately, the institutionalist theory results in a different set of predictions than those of the power-based perspective. However, it remains to be seen whether these predictions can work simultaneously to explain different aspects of regime formation.

A First Attempt at a Joint Model

Nilima Gulrajani's working paper released in February 2010 enters this debate with an interesting research question: can the power-based and institutionalist frameworks operate in the same space and together provide a more holistic description of how international financial regimes develop? Gulrajani argues that the power-based and institutionalist perspectives are compatible because they explain different forms of accountability at work within the international system (Gulrajani 6). While power-based frameworks rely on a utilitarian notion of costs and benefits, institutionalism's focus on cultural norms provides a space for policymakers to consider how reflection, altruism, and morality can affect state-level decision-making (Gulrajani 10).

Through case studies of World Bank involvement in Bolivia and Vietnam, Gulrajani explores this notion of compatibility between these frameworks. For these cases, Gulrajani assumes that the power-based approach manifests itself through negotiated contracts, and institutionalism appears in considerations of culture. In the cases of Bolivia and Vietnam, the World Bank dealt with both contracts and culture. The narratives describing the World Bank experience in each country detail the conflict between contractual obligations and cultural pressures. In other words, these cases illustrate the conflict that World Bank officials faced in these two developing countries when trying to administer standard contract-based programs while also considering the local culture (Gulrajani 18). Overall, the cases reveal how the power-based and institutionalist perspectives can apply to the same issue, when operationalized as contracts and culture respectively. Given Gulrajani's existing research, this study aims to further explore how financial regulatory regimes develop by examining the interactions between the power-based and institutionalist theories in the context of the Financial Stability Board case.

V. METHODOLOGY

My methodology consists of model building through the examination of a single in-depth case study. This case study focuses on the Financial Stability Board (FSB).

By analyzing the formation of the FSB, I aim to model how the power-based and institutional perspectives can interact in the same policy space. In other words, deconstructing the process of FSB development should allow me to generate a model of how power dynamics and cultural norms can both contribute to regime formation.

This FSB case study provides compelling research material because the body represents an emerging piece of regulatory architecture. Further, this case study offers increasingly relevant insight into institutional development, as the policy and business communities pay growing attention to the FSB. To date, few researchers have examined this case in depth or analyzed the FSB from a regime formation perspective. Overall, a case study or the FSB presents a unique opportunity to contribute to an emerging area of research.

For this single in-depth case study, I rely primarily on recent journal articles written by experts in the field. While analyzing these sources, I identify points where either a power-based or institutionalist perspective can explain the type of interaction that occurs.

It is important to note that this approach diverges from Gulrajani's methodology. Gulrajani operationalizes the power-based and institutionalist theories by paring each one down to an essential set of terms for which she can code. Gulrajani frames the power-based perspective in terms of enforceable contracts and argues that institutionalism reveals itself through culture (Gulrajani 13). To further understand how these concepts of contractual and cultural accountability are more concretely operationalized, see Table 1 below:

TABLE 1. Contractual and Cultural Understandings of Accountability: Key differences

	Contractual	**Cultural**
Standard of behavior	Objective	Normative
Agency	Autonomous	Embedded
Motivation	Self-interest	Moral
Practices	Explicit procedural	Implicit relational

Gulrajani, N. (2010). TABLE 1. Contractual and Cultural Understandings of Accountability: Key differences.

Although Gulrajani's methodology provides an interesting mechanism for framing and coding, her strategy does not provide enough variation when applied to the FSB case. Further, at attempt to use these criteria in respect to the FSB revealed a high degree of subjectivity in coding for contractual and cultural forms of accountability. Ultimately, Gulrajani's criteria do not provide a compelling distinction between the power-based and institutionalist approaches in the FSB context.

Instead, I define a set of hypotheses to describe the major outcomes that each theory predicts. If expert journal articles provide evidence validating an hypothesis, then the respective theory demonstrates possible explanatory power.

My hypotheses for each theory include the following statements:

Power-Based Theory:

1. If power asymmetries between the Great Powers and less advanced economies persist, then the Great Powers will have the ability to coerce second-tier economies into accepting suboptimum outcomes with disproportionately high adjustment costs.
2. A more individualized conception of the national interest will result in narrow cooperation, as evidenced by the emphasis of home county control.
3. If less developed economies demonstrate a divergent set of preferences from those of

the Great Powers, then the United States and the European Union will resort to forum shopping and will establish regulatory clubs.

Institutionalist Theory:

1. As compromise among states increases, the national interest will become more broadly defined, and states will become socialized into institutions based on shared values.
2. Knowledge sharing and peer pressure through networks will serve as the primary mechanisms for diffusing norms and values throughout the international system.
3. If state actors share a similar base of knowledge and principles, then they will achieve consensus more easily based on this area of prior agreement.

These sets of hypotheses facilitate an evaluation of FSB formation according to the power-based and institutionalist theories. If the power-based theory provides the most cogent explanation of FSB formation, then it would appear that power struggles among states alone determine the potential for broad regime development. Evidence for the institutionalist perspective would offer support for a more optimistic assessment of future opportunities based on the idea that shared norms and values can overshadow the implications of power differentials. Finally, evidence in support of both theories would reflect a world in which power dynamics continue to influence underlying conditions for cooperation, but common ideas also spark coordination efforts.

However, it is necessary to recognize that given the level of subjectivity that persists in the coding process, there remains room for coder error. Further, despite the articulation of these seemingly exhaustive hypotheses, there may be situations where the data remains ambiguous and challenging for the coder to interpret. Overall, these predictions allow for more explicit differentiation between these competing explanations.

VI. CASE STUDY: THE FINANCIAL STABILITY BOARD

The Financial Stability Board (FSB) represents the most recent innovation in the post-crisis push for increased regulation. Aspects of its history, mandate, policies, and structure offer insight into the relationship between the power-based and institutionalist theories. Ultimately, this case study reveals that the founding of the FSB marks a critical turning point in trends surrounding global financial regime formation. While the history of its roots in the Financial Stability Forum (FSF) mainly provides evidence of the power-based framework, the establishment of the FSB reflects a distinct shift toward the institutionalist approach.

History

The FSB finds its roots in the Financial Stability Forum (FSF). Founded in February 1999, the FSF signified an international response to the East Asian Financial Crisis (1997-1998). The major goal of this organization was "to facilitate networks of informal cooperation or information sharing" (Helleiner and Porter 14). In other words, the crisis period of the late 1990s demonstrated the need for increased international cooperation on the issue of financial stability. The resulting policy creation relied primarily on loose networks meant to encourage information sharing among states. Both flexible and similar to domestic policy approaches, this network-based strategy served as a politically viable option for financial officials representing national governments (Helleiner and Porter 15).

This form of governance illustrates a combination of both power-based and institutionalist hypotheses. The loose network offers room for flexibility, which the power-based school interprets as a mechanism ensuring home-country oversight of final policy decisions. This reservation of decision-making power at the state level in turn facilitates broad agreement. Meanwhile, the emphasis on informality and the value of networks reflects the institutionalist prediction that shared values and norms serve as the basis of institutions. Further, the prominence of information sharing informs the interpretation that as information asymmetries decrease, and international actors develop a set of shared knowledge and principles, then members will achieve consensus more easily. This arrangement illustrates how the power-based and institutionalist theories interact in the same space.

To serve this purpose of facilitating policy work on international financials standards, the FSF included representatives of major standards setting bodies (SSBs), international financial institutions (IFIs), and G-7 central bank authorities. Led by a chairman, the FSF also included a small secretariat for administrative purposes. Overall, the organization represented a renewed focus on international financial standards for the first time since the 1988 Basel Accords (Helleiner "FSB and International Standards" 3-4).

Yet the structure of the FSF presented a variety of challenges. In addition to its small staff, which made copious work difficult, the FSF faced the stumbling block of an ambiguous existence in the international order. First, the organization had no formal power, as national governments failed to ratify the body (Helleiner "FSB and International Standards" 3). In addition, the FSF lacked a clear mandate and suffered "institutional drift" in respect to its purpose (Baker 20). This absence of mandated power and a clear set of objectives constrained the organization's impact on financial regulation.

Further limitations hampered the FSF's legitimacy and influence. Legitimacy in this context requires three key institutional features: inclusiveness, "rule-governance," and "fair return" (the reasonable distribution of costs and benefits among participants) (Sohn 498-490). Embedded in this notion of inclusiveness is the idea that an organization must not simply include a wide array of decision makers on its roster, but it must also incorporate these stakeholders in the bargaining process (Sohn 490). Thus, the body's exclusive membership structure invited a first set of challenges to its legitimacy.[2] Although reforms introduced four non-G-7 members, major emerging economies, such as China and India, remained excluded (Sohn 493).[3] Further, the FSF allocated these four new members only one vote each, while the G-7 powers had three representatives per country at the table (Sohn 493). As predicted by the power-based school, narrow membership served the strategic purpose of avoiding the inclusion of emerging economy preferences, which would likely be divergent. The resulting homogeneity of preferences facilitated agreement by consensus (Helleiner "FSB and International Standards" 5). Even within the FSF, the members with the largest economies leveraged power differentials to force less dominant economies into accepting sub-optimum levels of representation. Ultimately, the exclusivity of the FSF, as evidenced by both its narrow membership and skewed representation among members, provides evidence for power-based considerations in regime development.

In addition, the FSF faced a legitimacy problem related to rule governance, as evidenced by both its internal policies and the external reforms it proposed. Both types of policies resulted from a highly informal negotiation process structured by few rules (Sohn 494). In particular, the process for adding items to the policy agenda and for suggesting the addition of new members remained ambiguous. Sohn highlights the lack of clarity surrounding the incorporation of non-FSF members in FSF working groups as a particular example of a frustratingly informal process (Sohn 494). Additionally, external policy recommendations frequently mirrored the expectations of liberalized Western economies (Helleiner "FSB and International Standards" 4). The United States took advantage of a generally accepted decision rule requiring uniform consensus to exercise a unilateral veto over the institution, thereby forcing its preferences onto less powerful

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[2] The FSF initially included the Finance Ministers and Central Bank Governors of the G-7 countries: the United States, the United Kingdom, France, Germany, Italy, Japan, and Canada (Financial Stability Board "History").
[3] New members included the Netherlands, Australia, Hong Kong, and Singapore (Sohn 493).

actors (Baker 19). Here again the power-based theory offers insight into the observed outcome: consensus between the Great Powers on regulatory policy drove ostensible convergence on policies reflective of a narrow conception of thee national interest. Further, the Great Powers leveraged institutional informalities to impose outcomes favoring their particular national interests on weaker powers. Ultimately, the power-based theory provides a reasonable explanation as to why the FSF faced challenges to its legitimacy based on rule governance.

Finally, FSF policy and activity invited criticism surrounding the idea of fair return. Typically, reforms to address domestic risks of financial crisis, such as high sovereign debt levels, pose asymmetric adjustment costs for developing economies (Sohn 494). Rather than focusing attention on capital flows across borders and hedge funds with huge amounts of international capital, the FSF focused its reform efforts on domestic initiatives to establish sound financial practices from a liberal perspective (Sohn 495). This focus on domestic policy changes offers evidence of an emphasis on home country control as a strategy to establish a cooperative regime. Further, as the power-based theory predicts, the roots of reform strategies in Western conceptions of sound economic policy signals a narrow conception of the national interest on the part of the Great Powers.

All together, the power-based theory informs an understanding of why the FSF faced challenges to its legitimacy based on the criteria of inclusiveness, rule governance, and fair return. Despite FSF efforts to include representatives of non-member countries in working groups, inactivity and plummeting authority remained pressing impediments to regulatory progress. The system shock of the 2007-2009 financial crisis finally served as the catalyst for change.

Founding of FSB Marks Transition from Power-Based to Institutionalist Perspective

In November 2008, the G-20 called for the FSF to assume a more robust role in global financial regulation. However, it also required that the FSF expand its membership (Helleiner "FSB and International Standards" 5). Given the near collapse of international finance, as well as more gradual shifts in underlying economic conditions, this response aligned with each country's broadened conception of the national interest.

While the global financial crisis provided the primary exigency for such a broadened perspective, more subtle changes in macroeconomic conditions also contributed to this expanded view. For example, the period from 2000 to 2009 witnessed a drastic realignment in global currency reserve holdings. In 2000, China possessed approximately 8% of the world's total currency reserves, while the United States maintained a similar stake near 6%. However, by 2009 the playing field experienced a dramatic transformation. While the U.S. share of global reserves declined to 4%, China's stake skyrocketed to 26% (The World Bank, author analysis). Thus, states began to internalize the perspective that establishing real international financial stability requires the buy-in and contributions of emerging global stakeholders. Yet they also found that considerations of power began to justify new patterns of cooperation.

This new perspective acknowledges the value of the power-based theory but highlights the increasing relevance of the institutionalist framework to describe regime formation. As the latter theory predicts, a shared understanding that financial stability demands a truly international effort inspired the expansion and renewed initiative of the FSF. Ultimately, this newly expanded, empowered organization emerged under a new name: the Financial Stability Board (FSB).

Mandate

Arguably its most distinctive feature, an expanded mandate separates the FSB from its predecessor. As Geithner suggests, this increased scope elevates the FSB to the status of a "fourth pillar" aside the IMF, the World Bank, and the WTO (US Treasury).

Although the FSB's main role remains predominantly one of "coordinator," new responsibilities include assessing system weaknesses, establishing best practices and supervisory colleges, conducting peer reviews, developing early warning processes, building linkages between Standards Setting Bodies (SSBs), and managing emergent crises, among others (Griffith-Jones et al. 6). For example, the FSB recently announced that it will establish groups to consult with authorities from both member and non-member countries in order to "exchange views on vulnerabilities affecting financial systems and on initiatives to promote financial stability" (Financial Stability Board "Financial Stability Board Proposes"). This initiative fulfills the Board's mandate to assess system weaknesses and to identify best practices. In addition, the FSB published its first peer review report, a detailed evaluation of the Mexican economy, on 23 September 2010. This report assesses Mexican bank performance, the state of the housing finance system, and current systems for monitoring financial risk (Financial Stability Board "Country Review" 5-6). Overall, this report signals the FSB's first peer review initiative with the goal of identifying opportunities to prevent future crises.

However, researchers disagree as to the predominant roles of the FSB within its mandate. For example, Eric Helleiner emphasizes the importance of responsiveness to G-20 direction, the formation of proprietary standards, and the administration/coordination of tactical reviews ("FSB and International Standards" 13). Meanwhile, Andrew Baker acknowledges the FSB's relationship to the G-20 and the role of peer reviews, but he introduces a new element by highlighting the organization's early warning function (Baker 20). Thus, there appears to be some disagreement about the key components of the FSB mandate. Overall, the FSB remains "focused on facilitating transgovernmental networks, with ultimate responsibility for financial regulation and supervision still resting firmly at the national level" (Helleiner "FSB and International Standards" 3).

This situation epitomizes the competing explanatory powers of the power-based and institutionalist perspectives. As the power-based school predicts, home country control over final policy decisions facilitates cooperation and general agreement. Yet the institutionalist theory offers insight into the role of transgovernmental networks. The FSB centers its work around network coordination because these linkages serve as a primary tool for both communicating information and diffusing norms throughout the international community. Additionally, a broadened conception of the national interest shaped largely by the recent experience of economic crisis incentives more inclusive, collegial cooperation in an institutional setting. Together, these two theories explain the situation of the FSB as a coordinating body for international financial governance.

Internal Policies

Two major components of FSB policy—its membership and its available mechanisms to ensure compliance—represent distinct shifts from the FSF model. The institutionalist framework offers primary insights into the motivations for these reforms, while the power-based approach continues to explain how changes in the relationships between states can also impact conceptions of the national interest.

Membership

Perhaps the most striking internal difference between the FSB and its predecessor is the organization's increased membership. Recognizing the G-20 as member states, the body includes a larger number of rapidly growing economies. Originally the FSF represented only 14% of the world's population and 65% of global GDP (based on G8 membership) (Vanoli 25). By comparison, the FSB globally represents 70% of population and 90% of GDP (Vanoli 25). Given the context of extraordinary system shock, this choice of expanded membership stems from a broadened conception of the national interest, as anticipated by the institutionalist school.

However, it is important to note that changing power dynamics, as evidenced by the shift in currency reserve holdings, also impact how states define the national interest in a way not necessarily predicted by a strict interpretation of the power-based school. This approach in fact suggests that as status quo asymmetries diminish, it can serve a Great Power's interest to coordinate with an emergent power. Further, the power-based theory reveals that the inclusion of representatives of these next largest economies may complicate the process for decision-making. If the incorporation of these additional perspectives dilutes the homogeneity of preferences, then it will be more difficult to reach a consensus (Helleiner "FSB and International Standards" 6).

The power-based approach, however, offers further insight into potential strategies to mitigate this increasing divergence of preferences. Experts foresee a shift toward an increasingly principles-based approach to policy in order to avoid the particular details that result in alienation and disagreement. If countries can agree on high-level standards, then they leave more room for individual interpretation at the national level (Helleiner "FSB and International Standards" 6). This prediction reflects the power-based hypothesis that international bodies achieve consensus through broad agreement on general principles with room for home country-discretion. Together, the institutionalist and power-based perspectives offer insight into the impetus behind the FSB's expanded membership.

Compliance Mechanisms

Strengthened compliance mechanisms further distinguish the FSB from the FSF. Currently, FSB members submit to assessment under the Financial Sector Assessment Program (FSAP) every five years and agree to the use of publicly available IMF and WB assessments to compile country-specific compliance reports. In addition, member states pledge to adhere to a set of 12 core financial standards. The FSB has stated that it will publicize the names of non-compliant states in order to enforce policy adherence. Finally, member countries also agree to submit to a peer review process, as seen in the recent Mexico case (Helleiner "FSB and International Standards" 9). Together, these broadened measure indicate an increased push for compliance.

The peer review process serves as a particular point of interest for researchers. As Porter notes, peer review comprises of two important components: accountability and linkages between states ("Making the FSB" 39). Most directly, this compliance mechanism represents an opportunity to hold nations responsible for their actions. In this context, it is likely that power dynamics impact enforcement of this process. Yet the focus on cultivating a peer network generates close linkages between member states as well as outside institutions. Overall, the peer review process, aside from increasing accountability pressures, encourages the development of shared views that dictate common expectations of behavior ("Making the FSB" Porter 39). Researchers also highlight the importance of shared beliefs to the peer monitoring process itself. Trust based on commonly accepted rules and behaviors allows for a common understanding of what accountability means. This understanding descends from the idea of "democratic accountability" (Siklos 57).

On the surface, this emphasis on bolstering enforcement measures extends from a power-based hypothesis, which implies the need for enforcement mechanisms to deter cheating. However, a closer examination of the peer review process demonstrates greater nuance. While the importance of power asymmetries reflects a power-based perspective, an understanding of the institutionalist approach informs the view that peer networks facilitate information sharing and trust-building. Ultimately, membership and compliance measures, two structural components of the FSB, offer insight into the increasing explanatory value of the institutionalist perspective alongside the power-based approach.

Structure

A study of FSB structure reveals continuing challenges to the organization's legitimacy. A chairman, who serves a three-year term with one possibility for reelection, leads the FSB. However, perhaps the most important decision-making body within the FSB is the plenary.[4] This group includes all member states, SSBs, and IFIs (Vanoli 24).

Two key aspects of the plenary highlight potential challenges to legitimacy that the FSB may face in regard to two criteria: the rule of governance and inclusiveness. First, the plenary operates by a general rule of consensus, as did the FSF (Vanoli 24). In theory, the Great Powers can choose to exercise their votes as vetoes to block policies more favorable to developing countries. Second, the assignment of voting power represents another controversial FSB measure. Currently, economic size, finance activity, and financial stability all impact the number

[4] Although not the focus of this analysis, the FSB also has additional internal bodies including the secretariat, the steering committee, and three standing committees. Each committee member requires recommendation by the chairman and appointment by the plenary (Vanoli 24).

of seats that each country has at the table. In general, these criteria tend to favor the developed countries over the developing economies (Vanoli 24), meaning that the Great Powers have a disproportionate voice in voting sessions.

However, these power-based concerns related to relative leverage and voting share carry less weight now versus the FSF era. The current period of economic crisis has revealed a turning of the tables in debtor-creditor relations. Now, the status quo Great Powers find themselves deeply in debt to traditionally less powerful economies. In particular, the United States depends on China's purchases of U.S. treasuries to finance rampant American consumption. China's artificially depressed currency, making its exports relatively cheaper than American-made goods, only exacerbates this economic imbalance (*The Economist* "Dropping").

In addition, China's interest in keeping its currency value low, while maintaining the Renminbi's tie to the dollar, limits China's monetary policy options. Although China shows intentions of pursing more diversified currency reserves, selling U.S. dollars to purchase other currencies risks the devaluation of the U.S. dollar relative to the Renminbi, thereby defeating China's overall strategy (*The Economist* "Rebalancing"). All together, this complex economic relationship between China and the United States vividly illustrates the increasing interconnectedness of the global community. Further, it also shows the emerging economic vulnerabilities of traditional powers like the United States. Given the growing number of U.S. treasuries that China holds, China has leverage as a negotiating partner in the global community (*The Economist* "Wary").

Overall, the example of U.S. relations with China sheds light on the continued importance of the power-based approach. A gradual realignment of the global order, in particular the polarization of debtor-creditor relationships, has caused states to realize their growing interdependence. As the power-based approach predicts, states have expanded their conception of the national interest to accommodate new allocations of power, thereby facilitating higher levels of cooperation between developed and developing economies than previously seen. Thus, the power-based framework offers compelling evidence as to why the structure of the plenary will prove less damaging than during the FSF period. Although institutionalism demonstrates increased relevance, the power-based approach also contributes to the story of how a broadened conception of the national interest sparked FSB formation.

Table 2 shown below offers a key summary of the relative explanatory powers of the power-based and institutionalist frameworks in respect to the FSB case. First, the FSF-FSB transition marks a critical juncture in regime theory. During the FSF era, the power-based theory provided the primary explanation of the rationale behind the organization's strategy, structure, and policies. However, the introduction of the FSB marked a clear increase in the explanatory value of the institutionalist framework. This new paradigm offers insight into the emerging focus on transgovernmental networks, the significance of more inclusive membership, and the intention of the peer review process.

Despite this clear shift, the power-based framework maintains critical value in understanding how changing power dynamics also incentivize cooperation on global financial governance. The power-based framework contributes nuance to the story of expanded membership and helps to clarify why operation through the FSB plenary represents a less serious threat to legitimacy than in periods past. Finally, Table 2 suggests an even more unexpected takeaway: like the institutionalist theory, the power-based framework can also help to explain the rise of a broader conception of the national interest. All together, these results demonstrate the growing relevance of the institutionalist perspective and the combined effects of the two theories operating in the same policy space.

TABLE 2. Comparison of Theoretical Explanations of Institutional Features

Aspect of Institution	Power-Based Theory	Institutionalist Theory
The FSF		
Flexible, network-based strategy	- Flexibility, room for home country control	- Emphasis on informal networks as mechanism to promote shared values and information sharing
Narrow membership structure	- Narrow membership ensures more homogeneous preferences - Great Powers can leverage power to establish regulatory clubs and to coerce lesser powers into accepting sub-optimum outcomes - Evidence of narrowly defined national interest	
Policies based on liberal, Western perspective	- Consensus among Great Powers drives policy convergence - Evidence of home country control and narrowly defined national interest	
TRANSITION		
The FSB		
Transgovernmental supervisory network with ultimate control at state level	- Home country control facilitates agreement	- Network forms primary tool for communicating information and for diffusing norms
Expanded membership to include second tier economies	- Shifting power dynamics incentivize broadened view of national interest	- Common realization that preventing global crisis depends broad international cooperation generates broadened understanding of national interest
Peer review process	- Enforcement mechanism to deter cheating	- Information sharing and trust-building through process contribute to norm diffusion through network
Continued operation through the plenary	- Reduced power differentials between traditionally dominant and second tier economies due to changing debtor-creditor relations	

Table 2 (shown above) illustrates a compared the power-based and institutionalist theories according to shifting explanatory power across time.

VII. CONCLUSION

This FSB case study illuminates several key conclusions. The first major set of takeaways describes the relationship between the presented frameworks, assesses their relative explanatory value, and describes the relationship between this research and Gulrajani's working paper. The next conclusions draw inferences about the emerging policy environment itself. Ultimately, these insights about the evolving decision-making context offer hypotheses that may prove helpful to policymakers seeking international cooperation.

The most evident takeaway from the FSB case is the increasing relevance of the institutionalist theory as a device to describe international cooperation on financial regulation. As this analysis demonstrates, the founding of the FSB signals a change in the relative explanatory value of the power-based and institutionalist frameworks. Prior to the 2007-2009 financial crisis, power asymmetries between developed and second tier economies offered the status quo powers a position of advantage. The Great Powers leveraged this advantage to either determine the policy outcomes of collective bodies or to form exclusive regulatory clubs favorable to homogeneous preferences. This strategy stems from a power-based conception of the global order.

The formation of the FSB, however, coincided with two distinct environmental changes: a shock to the economic system and a diminished power differential between traditionally dominant states and second tier economies. As demonstrated throughout the FSB case, both of these conditions helped to expand each state's conception of the national interest. Immediately post-crisis, states bought into the claim that international financial stability required coordinated action. As this idea diffused throughout the international community, the norm of cooperation became more accepted among the global network of states. This process provides evidence for the explanatory value of the institutionalist paradigm.

Yet the contribution of power-differentials to the expanded conception of the national interest demonstrates the continued value of the power-based framework. Further, it sheds light on an unexpected insight: the power-based theory does not necessarily coincide with a narrow conception of the national interest. Rather, considerations of relative power can incentivize cooperation if asymmetries diminish. This insight requires researchers to revise the assumed relationship between the power-based framework and a narrow interpretation of the national interest. All together, these factors illustrate the increasing value of the institutionalist approach while validating the continued importance of power-based insights.

Ultimately, these conclusions at least partially support Gulrajani's own findings. The institutionalist and power-based approaches can in fact operate in the same policy space. By explaining different aspects of FSB formation, the theories together provided a more nuanced description of regime formation. Rather than simply a consideration of power dynamics, financial regime formation also depends on the diffusion of norms, beliefs, and information throughout the international system. Yet the inclusion of power-based insights is necessary to fully understand how the conception of the national interest develops. As this research demonstrates, the conception of the national interest depends upon both considerations of power and the acceptance of common ideas. However, it is important to remember that the increasing value of the institutionalist framework remains a new phenomenon that seems to have emerged with the founding of the FSB. Gulrajani does not address the change over time in the relationship between the power-based and institutionalist frameworks. Thus, to fully support Gulrajani's conclusions would require a more detailed explanation of her empirical study and results, particularly her impression of how patterns of regime formation have changed over time.

Next, it is important to consider what these conclusions say about the global context for policymakers seeking solutions to problems with international effects, whether finance-related or otherwise. The institutionalist framework demonstrates explanatory success because, as suggested above, it addresses a key environmental change: the broadened conception of national interest as a result of shared beliefs about the nature of solutions to global problems. However, the power-based approach also achieves relevance because the underlying power dynamics among players on the international stage have changed. Thus, if policymakers want to achieve cooperation on international policy, they should acknowledge that the global order has changed in two distinct ways. First, the international community accepted, at least in the immediate post-crisis period, wide-scale cooperation as a mechanism for global crisis prevention. Second, traditionally second-tier economies have experienced distinct gains in power that have reshaped the bargaining environment. As a result of these changes, policymakers should leverage windows of opportunity in periods that emphasize international collaboration to establish cooperative regimes. However, power considerations also demand that policymakers pay heed to the preferences of those economies increasing in influence as measured by global GDP and currency reserve shares.

Ultimately, this research raises a variety of questions. Several appear intrinsically linked. First, and perhaps most critical to policy makers, will this notion of the broadened national interest last? Further, which aspect, either power differentials or shared ideas, most impacts how broadly the national interest is conceived? The most recent November 2010 meeting of the G-20 offers some insight into probable responses to these questions. As *The Economist* suggested in the days leading up to this meeting, "…there are signs that the G-20's utility has faded as the world economy has recovered" (*The Economist* "Finally"). The publication anticipated that divergent preferences over currency valuations, particularly between the United States and China, would limit potential cooperation (*The Economist* "Finally"). As predicted, this G-20 meeting resulted in little meaningful agreement. Members pledge to join in a study of global currency valuations, "…but on key issues members rejected comity in favor of national interests" (Davis and Paletta). All together, reports suggested that the expanded notion of the national interest present in the founding of the FSB had little relevance to the 2010 Seoul summit.

This latest development offers two key takeaways. First, it appears that this broadened notion of the national interest that inspired FSB formation represents a temporary phenomenon. As economies recover from crisis lows, the perception of the national interest grows increasingly narrow. Ultimately, this lesson underscores the importance of quick action by policymakers to take advantage of post-crisis windows of opportunity when shared beliefs about the need for solutions of truly international scope facilitate cooperation.

Second, the latest G-20 meeting demonstrates the importance of shared beliefs in maintaining a basis for collaboration. Since the 2007-2009 crisis, China has gained increasing leverage over the United States due to the impact of its monetary policies on U.S. currency and general economic health. Thus, the power split between the two nations has gradually become more equal. What has changed is the sense of urgency in developing global solutions to an international economic crisis. As economies recovery, this shared belief in the value of global cooperation appears to dissipate. Simultaneously, as evidenced by this G-20 summit, the conception of the national interest has narrowed. This example demonstrates the importance of widely accepted and shared beliefs to the perpetuation of a broadly defined national interest.

Overall, both the power-based and institutionalist perspectives offer key insights to policymakers about the contemporary economic environment. Underlying power differentials are changing, forcing policymakers to reconsider traditional notions of whether cooperation serves the national interest. In addition, an understanding of how norm diffusion and shared ideas can contribute to institutional development sheds light on how countries conceive the national interest across time. When the shared belief in international solutions to global problems diffuses throughout the world community, then a broadened construction of the national interest becomes more likely. This conclusion represents a cautiously optimistic perspective on future opportunities for regime development. Together, the balancing of historic power differentials and the general acceptance of the need for global cooperation can provide a key window of opportunity prime for regime development.

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APPENDIX A:

Figure 2:

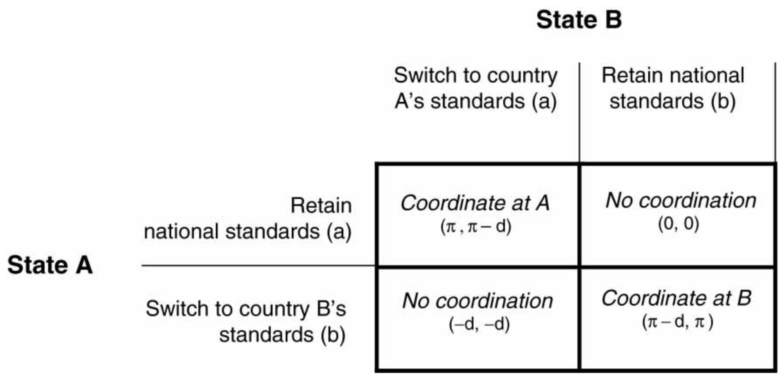

Figure 1 The coordination game
π = benefits from regulatory coordination
d = adjustment costs of switching standards

Drezner, D. W. (2005). Globalization, harmonization, and competition: the different pathways to policy convergence. F. 1.

Figure 3:

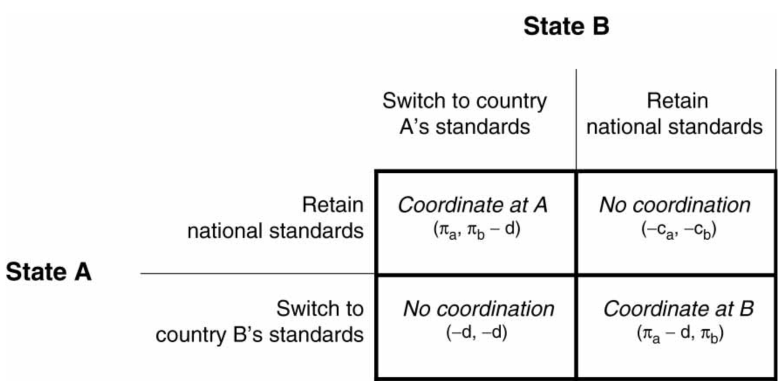

Figure 2 The modified coordination game
π = benefits from regulatory coordination
d_i = adjustment costs of switching standards for country i
$-c$ = costs to B of maintaining the status quo

Drezner, D. W. (2005). Globalization, harmonization, and competition: the different pathways to policy convergence. F. 2.