

APPLICATION FORM FOR PROSPECTIVE WORKSHOP DIRECTORS

If you wish to apply to direct a workshop at the Joint Sessions in Münster, Germany during 22-27 March 2010, please first see the explanatory notes, then complete this form, which will serve as the **cover sheet** for your workshop proposal. This form should be sent with your **workshop proposal** to the ECPR Central Services. You can do this by emailing both documents as an attached file (in word format .doc or rich text format .rtf) to the ECPR Central Services at ecpr@essex.ac.uk. Alternatively, you can print up the information and send it as a fax to the Central Services, fax: +44 1206 872500. **The deadline for applications is Sunday, 01 February 2009.**

Title of proposed workshop:

New Global Finance and the Politics of the World Economic Crisis

Subject area:

International Political Economy,

Abstract of proposed workshop. Maximum of 250 words (suitable for publication in the academic programme leaflet and on the ECPR web site):

What started as a burst of a speculation bubble in the US real estate market has in the course of just a couple of months developed into the most severe financial crisis since the Great Depression in 1929. What is characteristic of the Subprime Crisis is that the American real estate credit market was tightly connected to structures and processes of global markets: the slicing and dicing of subprimes was made possible by modern financial instruments like derivatives, modern practices like securitization, and new actors like Credit Rating Agencies who provided first class ratings and thereby suggested false security; and Hedge funds that generated the demand. The crisis is therefore as much a crisis of the modern capitalist economy. Its global spread and the wide ranging changes it triggered are cases in point: Financially, the amount of lost money is unprecedented; institutionally, it has led to greater transformation of the American and European financial markets than any planned reform could imagine; discursively, it has led to the collapse of monetarism and a revival of Keynesian monetary and fiscal policies. This interdisciplinary workshop critically assesses and analyses sources, dynamics and consequences of the global financial crisis

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(maximum of 2 persons) Timothy Sinclair, Oliver Kessler

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Please note that the information above is VERY important, as it will be used in all future correspondence and, if the proposal is successful, printed in the academic programme.

The proposal should be typed with 1.5 line spacing on three/four A4 pages using this sheet as the first page, and should cover the points outlined in the explanatory notes/guidelines available on the ECPR website at www.ecprnet.org.

For further information, please contact:

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Workshop Proposal

New Global Finance and the Politics of the World Economic Crisis

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Theme

What started as the burst of a speculative bubble in the US real estate market has in the course of just a few months developed into the most severe financial crisis since the Great Depression of the 1930s. At first sight, the Subprime Crisis seems to parallel past crises: the famous Tulip crisis in Amsterdam during the 1630s, the South-Sea bubble of 1720, the Great Depression of the 1930s, the Latin American debt crisis of the 1980s, the currency crises of the 1990s and the burst of the New Economy bubble in the year 2000. Some of the characteristics are quite similar: new investment opportunities, credit expansion, emergence of doubts, and finally the bursting of the bubble. On the other hand, the Subprime-Crisis is distinct from previous crises in specific features directly related to the structures of modern finance. Without actors like Rating Agencies, Hedge Funds and new (illicit) practices around securitization, the Subprime Crisis would not have been possible. The crisis is therefore as much a crisis of the modern financial system as a crisis of the entire finance-led capitalist economy. To understand the Subprime Crisis and come to sound policy proposals, it is necessary to both compare the Subprime Crisis with previous crises and set these into perspective with the structures of modern finance. It is essential to avoid continuing 'as if' the Subprime Crisis were just another incident in a long story, but to take the specific characteristics seriously, broaden the perspective and see financial markets as embedded in social, political and legal structures. Here, in particular five dimensions are important:

- (1) ***The bubble in the American real estate market.*** With interest rates low, and steadily growing house prices, the market for subprime mortgages and alt-A mortgages (mortgages issued with lower standards) grew rapidly.
- (2) ***Credit crunch: The securitization of credit*** by transforming mortgages into Collateralized Debt Obligations (CDO) and the privatisation of the mortgage market linked the American market tightly to global financial structures: the slicing and dicing of subprime mortgages into tradeable assets was made possible by modern financial instruments like derivatives, modern practices like securitization, new actors like Credit Rating Agencies who provided first class ratings and thereby suggested false security in the context of a market downturn; and Hedge Funds that generated the demand. At the same time, much of the trading did not show up in balance sheets. When the market collapsed, private banks lost trust in each other and the value of securities, leading to a collapse of the inter-bank lending system that greatly reduced the provision of credit and translated the financial crisis into an economic one.
- (3) ***Global spread:*** The global transmission of the crisis triggered world-wide bank runs and several bankruptcies of major institutions (like Northern Rock, Sächsische Landesbank). The contagion of turmoil was driven by *credit* channels: in particular Hedge Funds and banks whose investments were leveraged in order to maximise potential profit. When the crisis unfolded, these credit channels worsened the situation as banks simply refused to lend money to each other. The inter-bank lending system collapsed and even guarantees by governments could not restore the necessary trust.
- (4) ***The translation of financial turmoil into a global recession:*** The financial crisis has generated at least five distinct effects that have magnified the effects of the crisis into a global downturn. First, it undermined confidence in growth and prompted reconsideration of investment decisions by large corporations nervous about prospects. Second, the financial crisis and the end of the housing bubble made consumers, especially in the United States and Britain reign in spending and start to repair their personal balance sheets by reducing credit card debt. Unemployment in manufacturing and retail is rapidly rising. Third, small business credit dried up for other than the most solvent as commercial banks became more risk averse. Fourth, with reduced retail purchases China and other emerging markets have started to shutter factories and make workers redundant. Last, the fall of confidence has caused a 'flight to quality' from emerging

market assets into the US dollar, leading to very substantial falls in the Russian stock market in particular amongst others.

- (5) **Financial, institutional and discursive changes:** Financially, the amount of money lost is unprecedented. The cost of the crisis alone, excluding the costs for the real economy, are estimated at around US\$ 1.4 trillion so far US\$ (IMF 2008). Three times the cost of the Asian Crisis. Institutionally, in America alone, 11 major banks went bankrupt and the American big five investment banks are now subject to commercial banking regulation. Discursively, the crisis has led to a collapse of the monetarist belief in self-regulatory market forces. At the same time, in addition to the different national economies, the international system has experienced major changes. The classical crisis management mechanisms such as a concerted action by major central banks could not avoid the full manifestation of the crisis.

The magnitude of the crisis and the diversity and multiplicity of the dynamics and forces at play suggest that even if the specific problems causing the Subprime Crisis are resolved, the global, European and national political economies will inevitably have been changed for good. The Subprime Crisis will have created a structural break that is comparable to major events like the Great Depression (though the preconditions and structures are different) or the Bretton Woods agreement. This Workshop analyses the roots, dynamics and consequences of the Subprime Crisis. As the five dimensions show, the Workshop understands the current global financial and economic crisis as part of the Subprime Crisis because without the collapse of the Subprime market, the economic crisis would not have happened. Taking these five dimensions as a vantage point raises *four* further mutually interrelated problems that this workshop seek to address:

- (1) any attempt to secure financial markets has to take into account that systemic risks change constantly with new financial products and a changing constellation of actors.
- (2) this requires a better understanding of the specific roles and functions actors like hedge funds, rating agencies and instruments like derivatives play
- (3) in particular, the credit crunch results from a complete breakdown of institutional trust. Current endeavours show that simple state guarantees cannot restore the trust.
- (4) The role of credit: credit played a key role nationally and internationally. Domestically, credit in the form of mortgages was the driving force inflating the bubble. Internationally, and constituted by leveraging effects, contagion resulting from the Subprime Crisis occurred through credit channels. This was also apparent in the Asian crisis. In fact, its embeddedness in structures of global finance suggests that the distinction between domestic and international forms and functions of credit is not sustainable. In this sense, the scholarly literature lags behind current practices as it is still based on a clear differentiation between a domestic and international realm.

The workshop will bring together papers at three levels of abstraction:

1. Papers that take the Subprime Crisis as vantage point to inquire into more theoretical and meta-theoretical studies on the concepts of risk, finance, credit, and the contours of contemporary capitalist system
2. Multidisciplinary papers, discussing and comparing the global, regional and national level of the crisis, the role of new actors (Rating Agencies, Hedge Funds etc), practices (like Securitization) and instruments (like Derivatives, specific risk models).
3. Case studies of concrete political responses that for example reconstruct the discursive framing of national crises.

Relevant Literatures

The workshop draws on a broad, yet diverse array of literatures that deal with risk, the economic crises, varieties of capitalism and the political economy of financial markets. There are two main bodies of literature from which the workshop will draw most.

a) Social theory of risk and uncertainty:

While notions such as 'risk', 'uncertainty', or 'systemic risk' are widely used, they are hardly taken seriously as theoretical concepts in their own right. Although systemic risk is broadly understood as a failure of the soundness of financial markets, there is hardly any theoretical discussion of how systemic

risks emerge and are reproduced by the conditions of modern finance. When it comes to financial stability itself, as Gerald Schinasi (Schinasi 2006) has pointed out, economists define 'stability' by negation: as the absence of risks. There is a general idea of what stability means (for example the absence of bank runs), but the focus is on the regulation of specific risks like credit risk, liquidity risk etc. where a solid and predominantly economics-informed literature exists. For example, the IMF's *Global Financial Stability Reports* from April and October 2008 only provide a graph that *measures* the stability of the financial system by measuring specific risks like 'credit risk'. They don't provide any theoretical or conceptual discussion of systemic risks and how changing conditions of financial markets have contributed to the financial turmoil, one only finds quantitative comparisons that is: they treat heterogeneity exogenously. . That this approach is biased and insufficient has recently been pointed out by De Bandt and Hartmann (2000) and it will be the Action's task to provide a different understanding that defines stability not in static terms as a steady state or equilibrium, a definition that treats qualitative changes exogenously, but in dynamic, process-oriented terms (endogenous heterogeneity). Here, the workshop can draw from a solid literature in the social theory of risk (Adam et al 1992, Beck 1998, Bernstein 1996, Douglas 1985, Ewald 1991, Luhmann 1991, Lupton 1999, Krinski and Golding 1992, Zinn 2008), Varieties of Capitalism and Financialisation (Amable 2003, Cernat 2006, Carlin and Soskice 2006, Dore 2000, Froud et al. 2000, Hall and Soskice 2001, Konings 2008, Orhangazi 2008, Overbeek 2007), Political Economy of Finance (Best 2005, Sinclair 2005, Kessler 2008).

b) Hedge Funds, Rating Agencies, 'new global Finance'

The question of Hedge Funds was raised academically in the aftermath of the Asian Crisis. The literature focuses either on empirical reconstruction of their ability to shape market behaviour (Brown and Goetzmann 2001, Brown Goetzman and Park 1998, , Brown, Goetzmann and Ibbotson 1997, Eichengreen and Mathieson 1998, Fung and Hsieh 1999, Lie and Liu 1999) or theoretically analyse how the very existence of a heterogeneity of players alters market behaviour (Corsetti, Pesenti and Roubini 2001, Morris and Shin 1998, 2000), often discussed in terms of herd behaviour (Calvo and Medoza 2000), collusion, and the changing interaction between financial and political actors (Chakravorti und Subir Lall, 2000). Although there are an increasing number of official reports (IMF 1998, Financial Stability Forum 2000, 2001, 2002, President's Working Group on Financial Markets 1999), much work needs to be done to understand the role hedge funds play, the strategies they pursue and the systemic risks they produce.

Credit rating (or bond rating) agencies have been at the centre of official attention because of their alleged role in the subprime crisis. There is a substantial literature in financial economics on bond rating that focuses on the question of whether the agencies actually add information to markets. This literature is surveyed in Levich et al (2002). Surveys of how the agencies operate and the implications of their work can be found in Fight (2001) and Sinclair (2005). These works identify the foundations that underpin ratings and explore the effectiveness of the rating system. Kerwer (2005) argues that the role of the agencies has expanded because they provide a knowledge standard which provides a convenient yardstick in the markets. Archer et al. (2007), Biglaiser and DeRouen (2007), Bruner and Abdelal (2005) and Abdelal (2007) investigate the impact of ratings on sovereign states. The agencies have been widely blamed for failing to anticipate the fragility of Collateralized Debt Obligations in conditions of a falling housing market, and for procyclical actions during the summer of 2007 which helped to hasten the onset of the wider financial crisis by reducing confidence in the ratings of structured debt instruments. This has led to several inquiries by regulators and international professional bodies (SEC 2008; IOSCO 2008). Some critics in the financial press and amongst elected officials have noted the existence of conflicts of interest in the rating business which may have encouraged overly optimistic ratings during the years of asset price inflation. These observers have suggested that the role of rating agencies has been mistakenly expanded by governments in the past, giving ratings much greater impact than would otherwise have been the case. The existing analytical literature provides a good basis for examining these claims in the network.

Banks have dominated finance since the 19th century. They make money by lending to borrowers, whose interest payments they use to compensate depositors in a process known as intermediation. Financial globalization has put pressure on this structure, as interest rates charged to borrowers must incorporate overheads, including the cost of bad loans. Pressure to reduce these costs has stimulated a process of disintermediation (Sinclair 2005) and the emergence of what has come to be called the New Global Finance (Sinclair 2001) or the shadow banking system, in which money is lent and borrowed

directly in capital markets (Krugman 2008). Banks too have participated in these activities off balance sheet, increasing their overall risk exposures.

Likely Participants and types of paper

The workshop is an attempt to analyse the sources, dynamics and consequences of the current world economic crisis. It thus seeks not only contributions from International Relations theorists, Political Economists or Financial markets specialists, but in particular welcomes interdisciplinary contributions by economists, comparative political scientists, and economic sociologists. The crisis does not fit easily in disciplinary defined categories but requires conceptual work that calls into question the very categories by which we understand the history, present and possible future of finance. Given the theme, we expect the workshop to be attractive not only to scholars with different disciplinary backgrounds with an interest in interdisciplinary dialogue, but also from different research traditions: it provides a platform to discuss differences and similarities between different approaches where discussions are not focused on abstract 'epistemological' or 'ontological' questions, but focused on the subject matter. Additionally, we are convinced that this workshop is of particular interest to younger scholars who seek to pursue a PhD in the areas of risk/international political economy/ financial markets/ financial crises. The types of paper we seek to attract are thus both theoretical papers that reflect on different research traditions as well as more empirical papers that for example could discuss different aspects of the crisis, provide a comparison of manifestation in different countries, or highlight more systemic aspects of the crisis by highlighting the underlying social structures and processes such as discussed in the Varieties of Capitalism literature (broadly defined).

Possible external funding sources

We plan to approach three different addresses. First, we will apply to the European Science Foundation for funding under its Explanatory Workshop plan. There is a maximum fund of 10 000 Euros per workshop. Apart from the ESA, we will apply for funding at Thyssen Foundation.

Biographical notes.

Timothy J. Sinclair is Associate Professor of International Political Economy at the University of Warwick, and is the author or editor of six books. Sinclair is a political scientist whose work is concentrated in the field of international relations and the sub-field of international political economy. His research interests include theories of global governance, non-state private expert governance, the politics of global finance, institutional change in market societies, and new concerns with the political economy of entrepreneurship and military organization. The puzzles that motivate his work are derived mainly from debates in political science, behavioral finance, economic sociology and organization theory. Sinclair is an expert on the growth and regulation of international capital markets, and the bond rating (or wholesale credit rating) agencies, Moody's Investors Service and Standard & Poor's.

Oliver Kessler is Assistant Professor of Political Science at the University of Bielefeld. His main fields of research are international relations theory, world society studies, social theory of risk, and systems theory. Apart from international relations theory, he has published on the changing contours of security practices in the war on terror and the phenomenon of targeted killing. He currently serves as Research Coordinator of the Economic Sociology Research Network within the European Sociology Association.