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PRIVATE-PUBLIC PUZZLES:

Inter-firm competition and transnational private regulation

Daniel Mügge

Daniel Mügge is Junior Research Fellow at the Amsterdam School for Social Science Research.

ABSTRACT:

Much recent scholarship has acknowledged that private actors exert considerable influence on politics beyond the nation state. Conflating private governance with private authority, however, it is often ignored that public governance (international negotiations, for example) may equally be beholden to private interests. The question for scholars of private actors in transnational governance is therefore not only whether they have an influence at all--they normally do. Rather, the question is under which conditions transnational rule setting institutions will have a private or public character--whether they will be inside the domain of the state and inter-national organizations, or formally controlled by private actors.

Focusing on transnational business regulation, the paper presents several related arguments: First, in many cases transnational private regulation can be understood as a means dominant firms employ to stabilize their grip on a particular market segment and keep potential competitors at bay. Second, transnational private regulation is only likely to emerge if a stable 'conception of control' has emerged among the incumbent firms in a segment. Third, transnational public governance is likely to emerge if producer firms 'draw the state back in' in order to fend off competitive threats. These arguments are illustrated with three empirical cases studies from financial and business services: Eurobond underwriting, auditing and trading services for listed derivatives.

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1. INTRODUCTION

Since Cutler, Haufler and Porter published their seminal volume in 1999, ‘private authority’ in international affairs has received ample scholarly attention (Cutler, Haufler, and Porter 1999b). Authority in the global political economy, so the initial observation, slipped away from legitimate governments and re-emerged in elusive forms and places (Strange 1996). Studies published on the matter have clearly related to each other, but they have defined their object of enquiry differently—sometimes very precisely, sometimes less so (Hall and Biersteker 2002; Higgott, Underhill, and Bieler 2000; Josselin and Wallace 2001; Ronit and Schneider 2000b). Indeed, various issues seem to be at stake: The *power* or *authority* of private actors, the *level* of the exercise of this power, the *form of institutions* through which it is exercised, and the novelty of each of the above.

While all these are pertinent to the global political economy, studying the *forms of institutions* through which private authority is exercised may be particularly fruitful. Particularistic interests always pervade politics and rule making processes—‘within’ the state as well as ‘outside’ of it. What looks public can be beholden to private interests, whereas formally private rule making may be accountable to the general public. The empirically observable ‘variation’ is whether authority is exercised through private or public institutions. This paper focuses on this variation and asks: When will transnational regulation be set through private institutions rather than (inter-)state ones? This paper concentrates on specific institutions, namely those that regulate transnational business.

While regulatory institutions have historically been influenced by more than one factor (Braithwaite and Drahos 2000), I will argue that a crucial one has been largely ignored: the pattern of inter-firm competition in the sector concerned. We can assume that in principle, producers of goods and services prefer self-regulation to rule-setting through a public body. That way, they avoid interference by other stakeholders and can tame potentially ruinous competition. This should also apply transnationally. Codes of conduct and private industry standards are examples. However, I argue that producers may call on ‘the state’ to intervene at their behest when other firms use transnational private regulation to the formers’ competitive disadvantage. The result often is a relocation of regulation to the public domain. I

therefore hypothesize that producers support transnational private regulation unless it threatens the market incumbents' competitive positions.

At first sight, that seems to say little about public actors' willingness to acquiesce to such demands. Regulation is widely held to be a public task, exercised in the name of the public good (Herring and Litan 1995). But the politico-economic reality often looks different. Producers regularly 'capture' regulators and infuse policy with their own preferences (Stigler 1971). In industries with high economies of scale and a tendency to concentration, this appears to be particularly valid. In addition, the complexity of regulatory questions in knowledge intensive industries (e.g. biotechnology, finance, pharmaceuticals) sees public actors 'puzzle' about proper regulatory regimes, including the choice between self-regulation and public oversight. Goals are often abstract and regulatory means ambiguous. These uncertainties leave much room for producers to provide 'technical input' and mould regulation in their own favour. Under these conditions, producers' regulatory preferences, including those regarding institutional form, are likely to carry considerable weight.

Drawing these lines of thought together, this paper's central argument can be summarized as follows: Whether regulation of transnationally integrated market spaces is located in the private or the public domain depends on the intensity of competitive struggles among major firms in the segment concerned. If competitive struggles have been resolved and the population of firms has stabilized, transnational private regulation is likely. If such struggles remain unresolved, public regulation is more likely. For this mechanism to operate one central condition needs to be fulfilled: producer firms must exert strong influence on regulation in the sector in question. Otherwise, their preferences for private or public regulation may be overshadowed by other stakeholders' concerns.

Business and financial services are well suited to illustrate this mechanism. The second half of this paper presents three cases from this realm—Eurobond underwriting, international auditing standards, and derivatives trading and clearing—complemented by evidence from a study by Porter (1999). These three plus one cases capture variation on the variables central to the argument: the stability or instability of producer populations and the private or public nature of transnational regulation. In all cases unity among producers had the effect of keeping 'public intervention' at bay, whereas competitive struggles had the opposite result. Public actors got involved where they had not been. These cases cannot 'prove' the argument, not least because

‘isolating variables’ is difficult in complex issues like transnational regulation. They illustrate the hypothesis and lend it support. They provide detailed examples of the inter-producer dynamics this paper holds to be central to transnational regulation and the institutions through which it is effected.

2. TRANSNATIONAL PRIVATE REGULATION—A PRELIMINARY DEFINITION

This paper addresses the wide field concerned with ‘private authority’ in international affairs. Sensible discussion requires a clear definition of the object of study, however. What are the observations that beckon theoretical elucidation? Three traits unify most of the works cited above: First, they are interested in actors outside of what is traditionally considered ‘the state’ (the ‘private’). Second, they focus on activities that somehow feed into politics (‘governance’). Third, these ‘politics’ are located ‘beyond the nation state’ (and thus ‘transnational’). Clarification of these three traits establishes a provisional domain of enquiry.

For ‘private actors’ in the political economy, Ronit and Schneider have suggested a sensible definition:

[“private”] means founded and controlled by individual persons or corporate actors – or aggregates thereof – in the pursuance of specific individual or organizational interests. Private organizations adopt their own rules and seek to finance their own activities; they determine their own goals and are accountable to their founders and members (Ronit and Schneider 2000a: 8).

‘Public’, in contrast, refers to *actors* ultimately accountable to the general public (in democratic systems, that is), or *institutions* backed up by the legal enforcement capabilities vested in the state. However, the distinction between public and private actors does not coincide with that between the state and the non-state domain. The state is a set of social *fields* peopled by both public and private actors ‘where actors claim the power to make and enforce rules for all of the other actors in society’ (Fligstein 2001: 16).

Many scholars have focused on the power or authority that private actors command in global politics. Both power and authority are slippery concepts, however

(Guzzini 1993; Martin 1971). Neither are ‘*things* out there’ (and thus directly observable), but analytical concepts that—usefully defined—may enable succinct accounts of events (McLachlan 1981). Fuchs, for example, distinguishes between three ‘faces’ of power—relational, structural and discursive (Fuchs 2004). Such classifications clarify our thinking but do not explain why politico-economic processes turn out the way they do, and not otherwise. Discussions of power and authority often suffer from backwards induction. Neither is directly observable. Instead, outcomes are used to establish which actors ‘apparently’ commanded power or authority.

The way in which roles of private actors in conflicts over ‘value allocation’ have become institutionalised are much more readily observable. Analytically, these two—actors and institutions—should be clearly distinguished. Public institutions can be dominated by the interests of private actors. This is true in the transnational realm no less than in the domestic one—for example of intergovernmental negotiations about trade or the Multilateral Agreement on Investment. A useful focus, then, is on how private actors’ influence is *institutionalised*—how private actors ‘lock in’ their grip on a policy domain. Here, the core observation of many studies is that private actors increasingly craft binding rules for the transnational realm (for example trade or product standards) through institutions outside the public domain (the state and inter-national organizations).

The transnational element could refer to three things—the *actors* setting the rules, the ‘*level*’ of the rule-setting institution, or the *scope* of rules. ‘Transnational actors’ are hard to operationalize. In political economy, the concept has commonly been applied to corporations. Transnational corporations (TNCs) have often been defined negatively through a lack of a clearly identifiable ‘home country’. As Ruigrok and Van Tulder (1995) have argued, the fact that corporations are increasingly ‘multi-national’ has not rendered them ‘stateless’. Beyond corporations, the concept of transnational actors becomes more slippery. Where is the border between the individual actors and the institutions bringing them together? Are transnational business organizations, for example, actors themselves, or institutions connecting corporations? What about the World Economic Forum (Graz 2003)? Defining transnational private regulation via the ‘level’ of the institutions is equally difficult. The concept of ‘transnational’ has become popular because social processes affecting global cut across borders but do *not* lie on what IR theory used to consider a ‘higher’

level, ‘above’ the nation state. Rather, it appears most sensible to incorporate the transnational element through *scope of the rules* being set. This implies that a single set of rules covers an integrated cross-border market. This requirement stands in contrast to international regimes (e.g. trade agreements): Here, governments may recognize each others regulations or grant foreign firms domestic treatment while different rule sets for national markets continue to exist (Sobel 1994).

Understood this way, ‘transnational private governance’ refers to the setting of collectively binding rules through institutions that lie outside the domain of states where the rules apply in an transnationally integrated space. For short, ‘institutions outside the domain of the states’ will be called ‘private institutions’. As pointed out, this paper focuses on cross-border business activities. In that case, the ‘collectively binding rules’ are what we normally call ‘regulation’. Transnational private regulation can then be defined as regulation that is made through private institutions and covers business activities in a transnationally integrated market. A central question follows directly from this definition: When will transnational regulation be set through private institutions rather than (inter-)state ones?

The rules for cross-border transactions have been analysed as ‘international regimes’ in International Political Economy (Krasner 1983). Cutler et al. have argued that the concept could be adapted to ‘private international regimes’ (Cutler 2002; Cutler, Haufler, and Porter 1999a). Their definition overlaps with the one suggested above. The authors’ standards for ‘private international regimes’ are very high, however. The concept is contrasted with mere ‘business associations’ as a source of self-regulation. Yet *both* ‘private international regimes’ and transnational self-regulation through business associations are institutionalised forms of private rule-setting, and functionally equivalent in the sense of transnational private regulation. While Cutler et al’s concept certainly has its merits, this paper will therefore stick with ‘transnational private regulation’.

3. A THEORETICAL FRAMEWORK

This paper suggests that the effects of transnational regulation on inter-firm competition are the key to understanding its institutional form—public or private. Therefore, one could call this perspective the corporate competition approach. Its underlying hypotheses are simple. First, producers—rather than consumers, investors,

creditors, or the public at large—dominate business regulation. Second, producers' stakes in regulation concerns its effects on inter-firm competition and its contribution to stabilizing the population of producers. This also applies transnationally. Third, producers prefer self-regulation in principle. Fourth, however, producers will prefer public rather than private regulation if private rule setting, dominated by stronger competitors, endangers their own competitive position. Putting these together, the main hypothesis is that transnational private regulation is likely where competitive struggles among major firms have been brought under control through industry consolidation, national regulation, cartel formation or other intra-industry arrangements. Where competition is fierce, transnational public governance is more likely. This section reasons through these hypotheses one by one.

3.1 Producer influence

Studies of American business regulation argued that producers would systematically beat other stakeholders at influencing regulation (Becker 1983; Peltzman 1989; Stigler 1971). This was counterintuitive. Business regulation is commonly justified with reference to consumer interests or the 'public good'. The case for producer dominance built on Olson's insight about collective action problems (Olson 1965). Stigler had argued that producers had a double edge over consumers: Their relatively low numbers facilitated coordinated lobbying and high individual stakes induced higher investment into such activities compared to consumers.

A socio-economic perspective reinforces the case for producer dominance. Neil Fligstein (1996; 2001) for example has argued that the central pillar of 'market-making' is not the *introduction* of competition, but its *avoidance*.

Much of the market-making project is to find ways to stabilize and routinize competition. Much of the history of the largest corporations can be read as attempts to stabilize market for these firms in the face of ruinous competition and economic downturns. [...] Finding ways to compete that do not revolve around price competition alone has proved pivotal to producing stability for firms in all advanced industrial societies. (Fligstein 2001: 5)

Market stability—understood as the stability of populations of producers—stands centre stage. The survival of producers is constantly endangered unless social

institutions somehow reduce their uncertainties and risks. Examples of such institutions include monopoly and patent rights, tariffs against foreign producers, business regulation that locks in market positions, ownership structures that ameliorate competition, or the formation of business associations.

Two classes of social institutions are particularly relevant for our argument—rules of exchange and conceptions of control. ‘Rules of exchange’ define who can undertake which business transactions under which conditions. For example, who is allowed to offer mortgages or sell stakes in investment funds? Most business regulation falls into this category. Regulation may serve other purposes, too (for example enhancing ‘systemic stability’). But in effect it limits price competition by defining the ‘market boundaries’ and stabilizes the population of sellers. From the perspective of producers, this is its central feature.

In a nutshell, ‘conceptions of control’ refer to the general acceptance of the way a particular market is structured.¹ This includes ‘market boundaries’—whether, for example, a bank can sell travel insurance or not—but also which firms dominate a market segment. Markets with high economies of scale are commonly controlled by a handful of firms, the ‘market incumbents’. In stable times, they live in a form of ‘truce’.² They know that seriously challenging each other—for example through price competition—will entail losses for all. The outcome of such infighting is often undecided. Even takeovers, one of the safest, if least efficient, means of eliminating competitors, come with dangers of uncertainty and battles spiralling out of control. A conception of control prevails when the current market order, both in terms of market boundaries and the hierarchy among firms, is not seriously challenged, and the formal and informal limits to ‘admissible competition’ are respected.

The point is, then, not that free market competition is unimportant, but that it is by no means the only or even the main game in town. Most businesses have more modest aspirations than zapping the competition and becoming world-beaters; those that are world-beaters devote much of their energy to making sure they stay that way. (Clarke 2000: 40)

Population stability and the prevalence of a conception of control are therefore closely related even if not epiphenomenal. Neither of them can change *over longer periods of time* without the other changing as well. Should the population of producers become

unstable then that will eventually unsettle the conception of control—the cognitive reflection of the market situation—as well. At the same time, if a conception of control is challenged, for example by a firm that enters a new market segment or attacks market leaders, this will only result in enduring change in the conception of control if the underlying market order is permanently altered. If the challenge is unsuccessful, the conception of control will revert to its original form. Because population stability and the conception of control are thus related they will henceforth be treated as two sides of the same coin.

3.2 Private preferences and public consent

In stable times, rules of exchange reproduce the hierarchy of producers firms inscribed in the prevailing conception of control (Braithwaite and Drahos 2000). Once the population of producers has stabilized, market incumbents are eager to keep the legal environment constant lest their market lead is eroded. In addition, they may try to extend their grip on market segments, especially through pushing for access to foreign markets.

The rules of exchange—who can do what under which circumstances—can be both formal or informal, and public or private. Rule setting through private institutions (‘private governance’) figures at least as prominently in history as regulation through the ‘state’. Guilds prominent in the middle ages or the standards for ‘notes of exchange’ established by bankers are examples. Later, ‘self-regulation’ of industry segments became a common face of private governance.

Producers prefer such self-regulation to rule setting through public bodies. It inhibits other stakeholders’ pushing for their own preferences (transparency, lower prices, better quality, stable employment opportunities, etc.). When private governance is capable of stabilizing markets, incumbents have no reason to get public actors involved. This preference for self-regulation only lasts, however, as incumbents can agree on its terms.³ If, in contrast, they face unresolved competitive struggles related to regulation, it is unlikely that they will reach consensus. Firms feeling disadvantaged by proposed measures are bound to call on public actors to ‘step in’ and protect them. Thus, they push regulation into the public domain. A stable conception of control is therefore vital for the emergence of private governance.

As the commonness of self-regulation demonstrates, public actors often abide private self-regulation. This willingness grows with the complexity of the regulatory

issues involved. The less policy goals or policy instruments are self-evident, the more room producers find to set the regulatory agenda and suggest ‘solutions’ to problems they themselves helped define.⁴ Financial and business services again are good examples, producing a never-ending stream of ‘policy advice’, discussion papers, conferences with public officials, etc. On top, public actors have their own incentives to favour self-regulation. Design, monitoring and enforcement of regulation is costly, again in line with the complexity of the market segment in question. If an industry promises to address regulatory problems appearing on the political agenda through self-regulation, public actors will often be happy to agree. Whether the resulting self-regulation fulfils its self-set goals is of course open to question.

Regulatory policy networks are often fairly circumscribed (Rhodes 1997). Indeed, in both public and private governance a prime motive of ‘insiders’ to institutionalise access to policy is to keep ‘outsiders’ at bay. In contrast to ‘normal’ times, a policy domain can enter the political limelight in times of crisis—a market scandal, for example—punctuating the prevailing policy equilibrium (True, Jones, and Baumgartner 1999). Politicians normally outside the policy network get involved. They start initiatives under the banner of ‘tightening’ regulation to prevent future malfeasance. In the US, the Sarbanes-Oxley legislation emerging after the Enron and WorldCom scandals is an example. The EU crafted initiatives in response to problems at Ahold and the collapse of Parmalat. In such instances, the formal democratic accountability of public actors allows stakeholders other than producers and the population at large to leave their imprint on regulation.

Alas, such instances are the exception rather than the rule. Even when a wider audience becomes involved, producers normally do their best to ‘keep the state out’ and other potential stakeholders with it (Clarke 2000). One institutional solution is to leave rule-setting in the private domain but to add a layer of public oversight as to provide public actors with an ‘emergency brake’. In effect, such public ‘oversight’ often remains lax. It is of secondary importance for the argument developed here because it leaves the producers’ capacity to manage intra-industry competition through rule-setting intact. In the cases discussed below, this has happened with auditing firms and underwriters of Eurobonds.

Barring extreme cases, then, public authorities tend to pay heed to calls for continued self-regulation, reproducing existing limits to public ‘intervention’. If the political fallout of a crisis can be managed by resorting to ‘enhanced’ self-regulation, public

authorities are bound to give in. Unless producers themselves favour a stronger public role in regulatory policy, that is. This point will be picked up again below.

3.3 Regulating the transnational domain

The cross-border movement of people, goods, services and capital has long been subject to consciously designed rules. Departing from International Relations, neo-liberal institutionalism studied them as ‘international regimes’ (Haggard and Simmons 1987; Hasenclever, Mayer, and Rittberger 1997). Based on (misguided) notions of states’ ‘sovereignty’, it exhibited a bias towards intergovernmentally negotiated rules, neglecting ‘private governance’ in the transnational domain.

Transnational private governance, however, is hardly new. Studying international (in the parlance adopted here: transnational) patent regimes, Porter (1999) documents how British textile manufacturers in the 19th and US automobile producers in the 20th century used their dominance in the respective transnational market segments to install private patent regimes and thereby reproduce their grip on markets. His cases—discussed in more detail below—supported the notion that the population of producers in the cross-border market space must be sufficiently consolidated for a transnational conception of control to have emerged. Put differently, a group of cross-border market incumbents must have found ways to stabilize their market. Not that they have stopped competing with each other. Rather, they have found means—here through the private rule-setting—to keep potential challengers at bay.

Porter’s placed his case material in the context of ‘hegemonic decline’. Translated into the criteria employed here, this meant that market incumbents were all rooted in a single (hegemonic) jurisdiction where a conception of control had previously emerged domestically. Transnational private regulation emerged because competitive struggles had already been solved at home. In a contemporary context, the example of credit rating agencies is instructive: The institutions sustaining a global oligopoly of three firms—Standard and Poor’s, Moody’s and Fitch Ratings—are rooted in the American market for ratings. They stem from the 1973 decision of the Securities and Exchange Commission to formulate requirements for ‘nationally recognized statistical rating agencies’ (Partnoy 1999). Three decades ago this status was conferred on the same three firms now dominating globally. The transnational market population of credit rating agencies is stabilized through rules of exchange

(who can sell rating services under which conditions) and conceptions of control in the American market. For these producers it is unnecessary to craft functional equivalents on the transnational level as long as they remain unchallenged there.

There is no reason why firms controlling or struggling over a market segment need to come from a single national background, ‘hegemonic’ or not. It is equally possible that incumbents are rooted in multiple jurisdictions. Then a conception of control has to emerge in the transnational market place itself for transnational private regulation to become likely. In such cases, transnational trade associations serve a double purpose. They stabilize the population of producers through enabling cooperation on contentious issues and provide a forum for *de facto* self-regulation. To underscore that firms’ dominance in transnational markets is not necessarily wedded to a ‘hegemonic order’ the case studies presented below explicitly cover situations where incumbents come from single as well as multiple jurisdictions.

3.4 Bringing in public governance

So when should we expect transnational *public* regulation? Assuming that corporations tend to disapprove of public governance and that public actors tend to heed this preference, much of the content and intensity of public regulation depends producer supporting it. In domestic contexts, the accountability of democratic governments to stakeholders other than producers may temper the latter’s dominance, particularly in severe crises. The US’ Sarbanes-Oxley Act of 2002 as a response to the Worldcom and Enron scandals is an instructive but extreme example. Often, producers will respond to crises by offering ‘tightened’ self-regulation to pre-empt public intervention. Such an offer and its chances for success in turn crucially depend on industry unity.

In cross-border contexts, regulation’s implications for stakeholders other than consumers of often less direct; that weakens public actors’ accountability to the public at large and makes them even more beholden to producer interests. The trade policy-like aspects of regulation reinforce this tendency. In general, corporate actors will back public governance of cross-border exchange when competitive struggles have remained unresolved and corporations feel their very survival is threatened unless public authorities ‘take over’.⁵ Incumbents in an integrated market place face a trade-off when considering to call for public governance, however. On the one hand, it may keep potential competitors at bay. On the other hand, relocating regulation to the

public domain erodes the privilege of an industry's effective self-governance. Therefore, the threshold for calls for public regulation is relatively high.

Again, two scenarios can be distinguished. First, market incumbents that hitherto 'managed' a cross-border market without public 'help' may see their positions erode. Reasons vary: Their technological advantage may diminish, competitors may secure cheaper production factors, etc. Transnational incumbents call on public actors to 'lock in' their market position through formalized rules. This happened in the cases studied by Porter.

Second, dominant firms may contest the established conception of control and thereby create competitive struggles. Again, firms feeling 'challenged' are likely to call on governments to create a transnational public regime where none existed before. This strategy will only be effective if the government(s) in question control a sufficiently large market. Otherwise, threats for market closure—governments' main weapon—will remain blunt. Implementing protectionist measures would provoke retaliation. Then, the challenged firm with the smaller home market would be hurt more than the challenger still enjoying access to a big home market. Put differently, the threat of public intervention on behalf of firms with a basic interest in cross-border integration rings hollow if retaliatory measures might be even more painful.

Both scenarios are reminiscent of protectionism in classic trade politics. Yet they exhibit a central difference: Traditional protectionism aims to inhibit market access for foreign competitors. Protectionism combats transnational market integration. In calls for transnational public regulation, in contrast, private actors *support* such integration, but want to secure 'voice' in the rule-setting. While 'traditional' protectionism is a potential answer to competitive threats it falls outside the scope of this paper's focus on transnational regulation.

The corporate competition approach also suggests that a market segment may move in the opposite direction—from public to private governance—when the population of firms stabilizes. A number of scenarios are thinkable: Markets could become 'deregulated', transferring oversight to market participants themselves. Also, industry incumbents might develop 'voluntary' transnational standards that are more demanding than public ones. If such standards were adopted, private actors would *de facto* define the rules of exchange. This second mechanism has played an important role in transnational auditing standards, discussed below.

3.5 Central hypothesis

The corporate competition approach to transnational regulation addresses the question: When will transnational regulation be set through private institutions rather than (inter-)state ones? Its central hypothesis is that *rules for cross-border exchange will be set through transnational private regulation if dominating firms (incumbents) have managed to stabilize their population and a stable conception of control has emerged.*⁶ In contrast, if the population and the conception of control are unstable or become destabilized transnational *public* regulation is likely. The firms challenging the prevailing market order can be both new market entrants—outsiders—or established incumbents—and thus insiders—eager for a better market position. The described mechanism is bound to be strongest when the producers' grip on regulatory policy is firm.

The following three empirical cases illustrate the logic of the argument and how its constituent mechanisms 'work'. In the overview preceding them, they will be complemented by the case studies of Tony Porter that were briefly introduced before. The cases are not intended as 'proof'. Selected randomly, other political dynamics (e.g. consumer politics) might obfuscate the working of the mechanisms described here. Rather, the cases have been chosen to provide the variation that counts for the arguments—the stability of market populations and conceptions of control and the private or public nature of transnational regulation. In addition, they have been selected from market segments where producers have a big influence over regulation—wholesale financial services and auditing.

4. THREE CASE STUDIES

The presented argument consists of two components—incumbents' preference for private governance once their population has stabilized and for public governance when competitive threats emerge. The second half of the paper will illustrate both mechanisms in different scenarios. Three cases are discussed at length.

For the sake of comparison in this preceding overview, they will be complemented by Porter's studies of British textile and American automobile industries. At the height of their global dominance in the 19th and 20th century respectively producers established and enforced private rules regulating patents:

In each case leading firms were initially able to exercise authority with respect to international markets with the help of a set of private social institutions centralized in the hegemon's territory. (Porter 1999: 258)

Only with the onset of relative decline did British and US producers pressure their governments to formalize these rules through international regimes:

In the first [step], states were called upon by private actors to regulate the international flow of knowledge by the construction of a patent regime. Formalized, explicit rules provided by states therefore replaced the regulation of knowledge flows by informal procedures and by the effects of cultural and geographic distances. In the second step, following World War I, these new rules were used by private actors to construct powerful, multinational, and often very formal forms of private international organization – the cartels [...]. (Porter 1999: 254)

Producers' changing stance vis-à-vis public intervention was indebted to competitive decline. Porter's cases therefore evidence how market incumbents from a single jurisdiction push transnational regulation into the public domain in the face of competitive struggles. Table 1 contrasts it with derivatives listings where competitive struggles leading to public intervention emerged among firms from different national backgrounds. At the same time, firms sustaining control over a transnational market can come both from a single jurisdiction (auditing) as well as different national backgrounds (Eurobond underwriting).

Table 1. Overview of the cases

		Domain of transnational regulation	
		Private rule-setting	Public rule-setting/regime
Background of top firms in market segment	Single jurisdiction	<i>Auditing</i>	<i>Porter cases (formerly private)</i>
	Multiple jurisdictions	<i>Eurobond underwriting</i>	<i>Derivatives listings</i>

The cases' properties are summarized in table 2. Note the correlation between the stability or otherwise of the incumbents' population, the presence or not of a stable conception of control and the domain of transnational rule setting (private/public).

Table 2. Summary of case properties

	<i>Eurobond underwriting</i>	<i>Auditing</i>	<i>Derivatives listing</i>	<i>Porter cases</i>
Time span referred to	Mid-1980s to present	Mid-1980s to present	Mid-1980s to present	Late 18 th to mid 19 th century (UK), early 20 th century to post-war period (US)
Population of market incumbents	Stable	Stable	Unsettled by competitive challenges	Unsettled by competitive challenges
Conception of control	Emerged transnationally, cemented through trade associations	Emerged domestically (US)	Dissolved since Eurex' challenge of US firms	Dissolved since economic decline of former incumbents
Transnational rule-setting	Private (with indirect public oversight)	Private (with indirect public oversight)	Public (no formal regime before the challenge)	Public (private before the challenge)

4.1 The regime for Eurobond underwriting—private resistance to public intervention

Eurobond underwriting has seen a stable 'conception of control' emerge in a transnational market setting. With such a conception of control in place, top firms organized to fend off threats of public governance. Instead, they launched a new trade association to continue effective self-regulation.

'Underwriters' are financial institutions (often investment banks) that prepare the issuance of bonds, fill order books with interested buyers, and eventually sell the bonds.⁷ This is normally done through syndicates rather than individual banks. Thus, it is argued, risk is spread and the widest possible audience of potential buyers can be accessed. But syndication also serves to temper competition. For example, of the 49 deals where Deutsche Bank took the leading role in 1986, it invited Dresdner Bank and Commerzbank as co-managers in more than half of them (Walter 1988: 61). Coming from the same country, accessing an even wider audience was hardly the reason. Deutsche's third most important partner was Crédit Suisse First Boston (CSFB), featuring on more than half of the deals. In return, CSFB invited Deutsche to

co-manage a full two thirds of its own 55 deals in the same year.⁸ Fierce competition existed—and exists—side by side with cooperation between firms.

The population of firms has remained extremely stable for a business considered exemplary of free-wheeling capitalism. Of the top ten firms in the Eurobond market in 1985, all but two were been among the top ten in the 2003 league table for underwriting of what is now technically called ‘international bonds’.⁹ These firms’ market share was more than 60 per cent, up from a little more than 50 per cent in the mid 1980s.

In 1969, the top firms set up a trade body, the Association of International Bond Dealers (AIBD). Based in London, the Eurobond market had essentially remained unregulated. British authorities had turned a blind eye to operations involving only market professionals, most of which were foreign (Helleiner 1994). Regardless of location, the Eurobond market was as transnational a market space as one could imagine. Funds flowed effortlessly into and out of currencies, and financial institutions from around the globe participated in its business. With a handful of firms dominating the market, the banks were eager to keep regulation private and settle conflicts among themselves. Until the mid 1980s, Eurobond markets stood as a prime example of transnational private regulation, with rules set informally through the AIBD.

Initially, the AIBD covered both primary and secondary markets—the issuance of bonds and the consecutive buying and selling of them, respectively. Technological innovations had lowered the barriers to entry for the secondary market. AIBD membership reached several hundred firms in the mid 1980s. The primary market, however, continued to be dominated by a few dozen institutions commanding the capital and expertise to arrange billion dollar sales of bonds. Consequently, the AIBD became less and less suitable for coordination among the top firms in the primary markets and their effective self-regulation.

By 1985, the primary and secondary markets had grown apart sufficiently for the main underwriters (all members of the AIBD) to set up another—the International Primary Market Association (IPMA) (*Financial Times* 1985b). Here, membership was confined to firms who had lead-managed six bond issues in the previous two years or nine in the previous three. 44 investment banks passed the test. Today, 20 years later, the IPMA has 51 members. Through the IPMA, incumbents in Eurobond

underwriting regained exclusive control of rule-setting that growing AIBD membership had diluted.

At the same time, the IPMA formed a pre-emptive response to looming public oversight of the Eurobond markets. In the mid-1980s, the Financial Services Act was about to be finalized in the UK. One way or the other, Euromarkets would be integrated into the British future regulatory architecture. As volumes continued to grow, some of Wall Street's rogue practices associated with the 1980s began to find their ways in London's markets (Partnoy 2002). Industry officials started to advertise IPMA as a trade association to tackle such problems, decreasing the case for public governance. John Sanders, working for S.G. Warburg—which had pioneered Eurobonds two decades earlier—and IPMA chairman at the time, justified the organization referring to new technology and financial instruments. It was meant to confront “sloppy legal and documentation work and potentially harmful market practices” (*Financial Times* 1985b).

Through their new trade body, firms fought anything smacking of public oversight (*Financial Times* 1985a). During deliberations about future oversight structures, it helped that the British Securities and Investment Board had appointed a market practitioner, Richard Britton of Drexel Burnham Lambert, as director of international securities regulation. The eventual solution was about as favourable to incumbents as the situation permitted. The AIBD would become an international securities self-regulatory organization (ISSRO) and a designated investment exchange allowed to set its own rules. It paid for this privilege with supervisory obligations vis-à-vis the British government. IPMA, in contrast, got the best of both worlds. It set its own rules, too, but submitted them to the AIBD charged with ‘overseeing’ them. That way, it escaped legal obligations. Attempts by smaller players to get public actors more involved – for example the legal challenge mounted of Swiss banks against ‘unfair pricing practices’ of the ‘underwriting cartel’—did little to change that (*Financial Times* 1991a; 1991b).

In Eurobond underwriting a conception of control emerged that has remained stable over the last two decades. Once the incumbents' population had stabilized, these banded together to fend off public governance. Indeed, they maintain private regulation for Eurobond underwriting. This reproduction of transnational private regulation depended on producers' presenting a ‘common front’ to initiatives by public and smaller private actors to introduce public governance.

4.2 Auditing standards—the transnational extension of domestic dominance

The central difference between the auditing and Eurobond underwriting cases is that firms dominating auditing all have the US as their home market, whereas the top Eurobond underwriters come from a range of countries. Furthermore, with only four firms now dominating auditing, the conception of control has become rock-solid: further concentration is likely to invite heavy public intervention and therefore not an option in the industry. At the same time, the ‘Big Four’s’ lead is so big that another firm’s chance of catching up are minuscule. With such a ‘frozen’ market order, the potential for effective intra-industry organization has been even higher than in Eurobond markets. The top four auditing firms have not only preserved their influence on transnational rule setting, but even made successful attempts to extend this grip in the future.¹⁰

At present, auditing of large companies’ accounts is controlled by four companies—the Big Four accounting firms, KPMG, Ernst & Young, Deloitte Touche Tohmatsu, and PriceWaterhouseCoopers.¹¹ They are the product of mergers between the eight still dominating in the mid 1980s, minus Arthur Andersen which imploded after the Enron scandal. The Big Four are unrivalled market incumbents. Second tier companies (e.g. Grant Thornton and BDO International) earn less than a quarter in fees of what each of the Big Four makes annually.¹² This concentration is widely believed to be the limit of what public authorities (in the US in particular) will tolerate before radical public oversight becomes established (*The Economist* 2005). Therefore, the Big Four have a stake in each other’s survival. Reproduction of the status quo, not fierce competition, is the order of the day.

From the perspective of the corporate competition approach, it is not surprising that the cross-border regime for auditing standards—the International Standards on Auditing (ISA)—was drawn up by a private body: the International Auditing and Assurance Standards Board (IAASB), part of the International Federation of Accountants (IFAC).¹³ In auditing, however, attempts by the Big Four to control transnational auditing standards and keep public actors out go further. The IFAC has national accountancy associations as members, not individual firms. While the Big Four wield significant influence, the membership-through-national-associations leaves smaller firms considerable say in IFAC’s affairs. As with

Eurobond underwriting, top firms have felt compelled to organize on a more selective basis once public sector threats to their self-regulation emerged.

In auditing, this challenge came with the single European market that was bound to include a pan-European auditing regime. Rather than working through the Federation of European Accountants or IFAC, the top eight auditing firms established the European Contact Group (ECG) in 1993 to lobby the European Commission for continuing self-regulation.¹⁴ The Commission presented its Green Paper on Auditing Standards in November 1996; the ECG tabled its own proposal simultaneously (*The Accountant* 1997). In a pre-emptive move, the latter outlined all steps the ECG felt needed to be taken to craft an effective auditing regime for Europe without serious public oversight. Its plan carried the day. In May 1998, the Commission published its decision to opt for ‘monitored self-regulation’ of the industry rather than a legal detailed framework for auditing in Europe (*European Accounting Bulletin* 1998).

Less than two years later, the very same firms behind the ECG set up a new body, called the Global Steering Committee (GSC), within the framework of the IFAC (*Accountancy* 2000).¹⁵ Again, the idea was to establish a body representing the top firms’ interests in response to what in industry parlance are called ‘regulatory challenges’. The Global Steering Committee created the so-called ‘Forum of Firms’ (FoF) within the IFAC—a company-based platform meant to sidestep IFAC’s ‘bias’ in favour of national associations rather than individual firms (*Accountancy Age* 2000). Nesting committees and forums one into the other, the FoF finally founded the Transnational Auditors Committee (TAC); it also nominates its members. This TAC set out to identify ‘issues’ in audit practice and act as a ‘formal conduit among transnational firms and international regulators and financial institutions’.¹⁶ And indeed. The Financial Stability Forum—the body created by the G7 to collect financial sector ‘Standards and Codes’—lists the Transnational Auditors Committee as one of the bodies through which the auditing industry is drawing up standards serving as global templates (Financial Stability Forum 2004).

The creation of the Public Interest Oversight Board (PIOB) in February 2005 has introduced elements of transnational public regulation in international auditing standards. Comprising members of international (regulatory) organizations, the PIOB’s task is to ensure that private standard setting bodies—the IAASB and the TAC—take the ‘public interest’ into account.¹⁷ Its establishment follows high profile corporate scandals in which auditing irregularities or even fraud figured prominently

(Parmalat, Ahold, etc.). It has also followed the creation of the Public Company Accounting Oversight Board (PCAOB) in the US. In addition, the Federation of European Accountants had pressured the European Commission to set up a similar body itself (Fédération des Experts Comptables Européens 2003). Thereby, it hoped, European auditing firms might escape the PCAOB's registration requirement (*Financial Times* 2003b). Given their recent nature, these developments lend themselves to conflicting interpretations. Clearly, high profile scandals lifted auditing standards onto the political agenda. In the US, this has resulted in the Sarbanes-Oxley Act and the PCAOB in 2002. A year later, the European Commission announced it would also introduce some sort of a public oversight regime. Given that final decisions are only expected later in 2005, however, it is impossible to say where standard setting authority will ultimately lie. The Commission has made two things clear: It closely cooperates with the PCAOB on a harmonized regime, and it intends to make International Standards on Auditing mandatory throughout the EU—extending the sway of IFAC and the firms dominating it. The PIOB will oversee IFAC's work. But because PIOB's members are international (regulatory) organizations, rather than national or EU representatives, smaller auditing firms will have difficulties tilting transnational regulation in their favour through increased public oversight. At any rate, this oversight will not impair market incumbents' ability to use rule-setting in their own interest.

In sum, auditing standards constitute a prime example of transnational private regulation dominated by a few market incumbents. The latter have used private associations to not only reproduce, but extend their grip on transnational rule making as developments up to 2002 document. Recent market scandals appeared to have discredited self-regulation of the auditing profession. Elements of transnational public governance—both through the PIOB and the PCAOB-EU cooperation—emerged in consequence. On the one hand, this has brought purely private governance dominated by the Big Four to an end—though this was not prompted by actions of competitors. On the other hand, increased public oversight has put the creation of transnational harmonized auditing standards high on public actors' agenda. What incumbent auditors have lost in independence (but not necessarily influence) may be more than compensated through further integration of the transnational market place that they are certain to dominate.

4.3 Derivatives Trading—calling in the state to fend off competition

In contrast to Eurobond underwriting and auditing, no transnational private regulation has emerged in the market for derivatives listings.¹⁸ Riven by competitive struggles that challenged the hitherto prevailing conception of control, major exchanges have dragged the issue into the public domain. The case illustrates how firms use public governance to address competitive threats in transnational market places.

Modern derivatives trading has its home base in Chicago. More than hundred years ago exchanges were established to trade future contracts for agricultural products. This legacy survives in the names of today's US incumbents, the Chicago Board of Trade (CBOT) and the Chicago Mercantile Exchange (CME).¹⁹ In June 1972, the CME introduce exchange-traded financial derivatives in reaction to the disintegration of the Bretton Woods system.

Derivatives exchanges sprang up globally in the years which followed. Their products allow investors to 'insure' themselves (hedge, in the jargon) against volatile exchange and interest rates. Until the 1990s, these exchanges' products referred to their home countries' currency, domestic bonds, or stocks listed on domestic exchanges. In countries with several exchanges (as the US), products were *de facto* divided between them. Exchanges expected and accepted non-intrusion on each others turfs. Effectively, derivatives exchanges enjoyed quasi-monopolies. Owing to the prominence of American markets and the US Dollar, the CBOT and the CME held 75 per cent of global futures trading as late as 1985 (*Financial Times* 1990).

Even though derivatives trading was a global industry, the service providers—the exchanges themselves—had a firmly established conception of control: Contracts would be traded in their 'home country'. The one exception was London's LIFFE exchange that dominated European government bond futures in the first half of the 1990s. By introducing new technology in 1997, its German counterpart, the Deutsche Terminbörse, repatriated Bund futures trading within months. To date, this is the only example of an derivatives exchange dealing a crushing defeat to another one through a cross-border battle.

Competitive pressures built up in the background, however, as the European exchanges consolidated—for example when the Swiss Soffex joined forces with the DTB to form Eurex. Euronext, the result of a merger of the Dutch, French and Belgian stock markets, in turn bought London's LIFFE in 2002. Only two big players

were left, both with sufficient size to assault the US futures market, still controlled by the CME and the CBOT.

Through arrangements reminiscent of those described by Porter in textile and auto production, exchanges had cemented the mutual acceptance of each other's positions through technology sharing, for example in trading software. Eurex entered such an arrangement with the CBOT in late 1998, with an inbuilt expiration date of January 2004. The cosy coexistence of derivatives exchanges collapsed, however, when in 2003 the CBOT rejected an extension of its link with Eurex, and switched to Euronext.Liffe instead. While disappointed, Eurex had planned for such a move: It opened the battle for global derivatives trading by announcing that it would open its own exchange in Chicago (*The Banker* 2003).

Thus far, neither transnational public nor transnational private governance had emerged. The competition was sufficiently tamed by a conception of control that attributed products to their 'national' exchanges. Once Eurex announced its intention to intrude on the CBOT's turf, this crumbled. The CBOT and the CME started lobbying US Congress to fend off the competition or find ways to delay Eurex' entry so they could prepare themselves (*Financial Times* 2003a). In an initial compromise the US regulator of the futures industry, the Commodities and Futures Trading Commission (CFTC), allowed Eurex US to start operations, but without Eurex' trump card, the so-called transatlantic clearing link with large cost-saving potential. Accordingly, Eurex US failed to win substantial market share from the CBOT in 2004 (it captured 5 per cent of the top CBOT's contract's trading, at best).

At the behest of the European exchanges and particularly Eurex, the EU's public body for securities markets, the Committee of European Securities Regulators (CESR), pleaded with US authorities. Sure enough, in October 2004, the CFTC allowed Eurex US to use the transatlantic clearing link. On the very same day, the two bodies announced cooperation on an 'Action Plan' to address cross border issues (CESR 2004). This transatlantic cooperation was cemented in February 2005. At a conference the two regulators agreed to launch a formal series of round tables and lay the foundations for a transnational futures trading regime (CFTC 2005). The link between this initiative and the competitive struggle was for everyone to see: Two of the four conference speakers on 'exchange issues' were Rudi Ferscha and Eric Wolff—the directors of Eurex and the CBOT, respectively.

Where a ‘truce’ had reigned, rising cross-border competition between derivatives exchanges pushed transnational regulation firmly into the public domain—which of course did not mean that ‘the public’s’ concerns were heeded more than before. American incumbents had used political clout and convinced regulators and Washington politicians to amend rules in their favour. European firms in turn lobbied public EU actors to raise the issue with US authorities. With these steps taken, the only way to address future competitive conflicts is through a public regime, negotiated by the public authorities of jurisdictions housing the main competitors.

5. CONCLUSIONS

This paper has asked why rule setting for integrated markets sometimes takes the form transnational private regulation while it effected through institutions in the public domain at other times. Transnational private regulation is likely to emerge, it has argued, in transnational markets where a stable conception of control has emerged among producers. Once that has happened, producers are likely to try to fend off public oversight in order to ‘keep other stakeholders out’ of rule setting, and to keep smaller competitors at bay.

The cases have illustrated the intra-industry dynamics that this paper argues are central to transnational private regulation. Eurobond underwriting and auditing have illustrated how transnational private regulation has emerged in markets with a strong conception of control and other competition-taming institutions. Trading in listing derivatives, in contrast, has been an example where competitive struggles among dominant firms brought about public regulation.

How widely through different sectors should the presented arguments be applicable? The argument about producers’ demand for private or public regulation is of a very general nature. More difficult is the question of public actors’ abiding private demands. This seems to be strongest in sectors with a fairly low ‘visibility’ (lowering the political salience—contrast derivatives with ecological disasters), high economies of scale and a high complexity of regulatory issues. It will be left for further research to test these factors importance and further improve our understanding of transnational politics.

From a normative perspective, the ‘keeping-other-stakeholders-out’-element of transnational private regulation is worrying. In a nutshell, accountable rule setting

would mean that all those affected by practices covered by a particular set of rules are also somehow involved in setting or at least overseeing them. Transnational private regulation works in precisely the other direction. In the case of finance, the general damage done by recurrent crises in the markets dramatically illustrate just how wide the stakeholder base of financial market governance is. The lack of accountability goes further, however. In a wider sense, markets themselves—and certainly financial markets—are a form of governance, a mechanism for allocating values throughout society. This function of ‘markets as governance’ makes a wider accountability of rule setting even more pertinent, and transnational private regulation even more disturbing.

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ENDNOTES:

¹ Note that as used here, ‘conception of control’ does *not* refer to the control of (parts of) a firm through corporate networks—a usage popularised by Ruigrok and van Tulder. Compare Ruigrok, Winfried and Rob Van Tulder. 1995. *The Logic of International Restructuring*. London: Routledge.

² For an excellent empirical illustration of these mechanisms in financial services, see Augar’s insider account of British investment banking since the early 1980s. It shows how both informal rules and the prevailing market order were widely accepted and remained unchallenged until upset by the Big Bang. Augar, Philip. 2000. *The Death of Gentlemanly Capitalism*. London: Penguin Books.

³ This includes privately set terms of extra-judicial settlement procedures, for example in commercial disputes. Firms will only support such mechanisms as long as the benefits of staying out of the public domain in general outweigh the costs of facing disadvantageous settlement results.

⁴ On the ambiguity of regulatory solutions in financial markets, see e.g. Henry Laurence, *Money Rules: The New Politics of Finance in Britain and Japan* (Cornell University Press, 2001), p. 26ff.

⁵ Obviously, many protectionist measures are in this category. The majority of them are irrelevant to this discussion, however. Even if negotiated bi- or multilaterally (rather than imposed unilaterally), these measures do not apply to the integrated market place but to individual countries. They are not incorporated a the general rule set applying transnationally. Therefore, they are outside of the scope of transnational regulation as understood here. In contrast, those ‘protectionist’ measures that *are* relevant here are those that are reflected in the rule set as it applies to all cross-border market activities in a given segment.

⁶ As pointed out, the stability of a population of producers and of the conception of control are closely linked. They are therefore not two independent variables.

⁷ Technically, the term ‘underwriter’ refers to its pledge to buy the bonds it cannot sell to third parties itself at the price previously agreed. In practice, ‘underwriter’ is used as a label for investment banks offering all the mentioned services. Eurobonds are bonds (i.e., tradable chunks of debt) sold outside the issuer’s home country. Normally, the currency is different than the issuer’s ‘home’ currency and ‘professional investors’ are the only eligible buyers. The Eurobond market originated in 1963 when S.G. Warburg raised \$15m for the Italian Autostrada in London. Before the year’s end, \$148m of such deals were be completed. By 1968, the market had risen to \$3bn. Since then, yearly issuance has come to be measured in hundreds of billions per year. Ingo Walter and Roy Smith. 2000. *High Finance in the Euro-Zone: Competing in the New European Capital Market*. Pearson Education: Harlow. p.68f.

⁸ Similar, if less extreme patterns prevailed among other important players such as Nomura, Banque Paribas, Daiwa, Nikko Securities, Morgan Stanley and Salomon Brothers.

⁹ For the 1985 and 2003 figures, see Ingo Walter. 1988. *Global Competition in Financial Services*. Cambridge, Mass.: American Enterprise Institute/Ballinger. p. 93. and Thomson Financial. *All about equities*. Press release. September 30, 2003. For the comparison, Citigroup has ‘inherited’ the position of Salomon Brothers which it acquired and incorporated (by then as Salomon Smith Barney) in the late 1990s. In sample period, the first nine months of 2003, ‘international bonds’ accounted for more than

half of global debt issues on capital markets. Thomson Financial. *Slip and fall*. Press release. September 30, 2003.

¹⁰ For clarity, it should be emphasized that the rule making processes for international *accounting* standards are distinct from those for *auditing* standards – even though both are arguably dominated by the Big Four accounting firms.

¹¹ As of 2004, of listed US companies with sales of over \$250m, a full 97% were audited by these four. All top 100 British companies are audited by them, and they are believed to hold a hefty 70% of the European auditing market by fee income. To get an impression of the size of the market: Average 2003 revenues of each of the Big Four firms were a little more than \$13,7bn; on average, each had more than 110,000 employees. *The Economist*. 'Called to account'. November 18, 2004.

¹² In the mid 1980s, the US market was still dominated by eight companies, but mergers between them (plus the implosion of Arthur Andersen in the wake of the Enron scandal) have reduced their number to four.

¹³ ISA are not legally binding. With national accounting association as its members—many of which also are involved in national standard setting—standards developed in the IAASB cascade down to the national level. More recently, however, ISA have been integrated in the 'Compendium of Standards and Codes' of the Financial Stability Forum, a point to which we will return below.

¹⁴ At the time, those eight companies were KPMG, Price Waterhouse, Coopers & Lybrand, Ernst & Young, Grant Thornton, Arthur Andersen, Deloitte Touche Tohmatsu and BDO International. Jim Kelly, 'An independent line', *Financial Times*, November 28, 1996.

¹⁵ Actually, because Price Waterhouse and Coopers & Lybrand had merged in the meantime, the GSC had seven founding members, rather than the eight of the ECG.

¹⁶ See <http://www.ifac.org/TransnationalAuditors/index.tmpl>, as accessed on March 15th, 2005.

¹⁷ PIOB member include for example from the World Bank, the International Association of Insurance Supervisors, the Financial Stability Forum, the Basle Committee of Banking Supervision, and the International Organization of Securities Commissions.

¹⁸ Derivatives are financial instruments whose interest is 'derived' from another asset, for example stocks, commodities or government bonds. They include future contracts, options, swaps, and myriad combinations of these. Derivates come in two groups—exchange traded ones and over-the-counter (OTC) derivatives. The former are highly standardized. OTC derivatives, in contrast, are basically direct contracts between two parties, custom-tailored to their needs. This section focuses on the former variety and the services provided to traders through listing, quoting, potentially clearing, and supervising trading activity.

¹⁹ The third large but recognizably second-tier player in Chicago is the Chicago Board Options Exchange (CBOE).