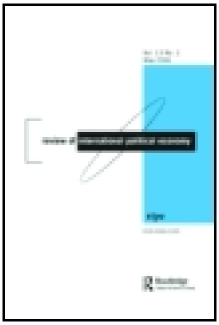

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Making global markets: Historical institutionalism in international political economy

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Introduction

Making global markets: Historical institutionalism in international political economy

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ABSTRACT

As dramatically evidenced by the global financial crisis, the interaction of domestic regulatory systems has significant international consequences. Nevertheless, these relationships have received only limited attention from international relations scholars. This special issue, therefore, provides a detailed examination of international market regulation – the processes through which the domestic regulatory activities of states and other actors set the effective rules of internationally-exposed markets. To this end, we borrow and extend on arguments developed by historical institutionalists in comparative politics and American political development. In particular, the contributions adapt two mechanisms – policy feedbacks and relative sequencing – to explain state and bureaucratic preferences over international market regulation as well as bargaining strength in relevant negotiations. In addition to contributing to central IPE debates about international economic governance, the individual contributions shed light on a number of important empirical domains such as corporate accounting, intellectual property, pharmaceuticals, hedge funds, and financial market standardization.

KEYWORDS

International political economy; markets; historical institutionalism; institutions; institutional theory; international relations.

How do national rule systems shape outcomes in global markets? This is an important question for scholars of international political economy. In the wake of the worst financial crisis since the Great Depression it is furthermore of major empirical significance. Issues that were previously

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primarily subject to domestic market regulation[1] within discrete territories ruled by sovereign actors, have become the locus of cross-border conflict and cooperation. Accounting standards, stock market regulation, mortgage lending, food safety, data privacy, and industrial chemicals are just a few policy areas where national market rules have roiled economic relations among the major advanced industrial economies. This confronts policy-makers with the challenge of managing interdependence between different national regimes, a challenge that has stark implications for domestic and international economic policy.

A growing body of scholarship examines how or whether the international forces of globalization constrain domestic regulatory politics (Berger and Dore, 1996; Garrett, 1998; Vogel and Kagan, 2004; Eren-Vural, 2007; Mattli and Woods, 2009). To understand the opposite causal relationship – how domestic regulatory rules may have international economic and political impact – we propose that it is necessary to pay more attention to what we dub *international market regulation* – the processes through which the domestic regulatory activities of states and other actors set the effective rules of internationally-exposed markets.

International market regulation involves important causal relationships that do not map well onto the traditional subdisciplinary divisions between international relations and comparative politics. The primary focus of international relations scholarship has long been on the outward facing aspects of the state; the state's role as an international negotiator with other states, wager of war, or creator of international institutions.[2] While new literatures have emerged challenging the state-centric account of international affairs, they have typically either examined how non-state actors are creating their own forms of international order (Cutler *et al.*, 1999; Haufler, 2001), or how they may influence intra-state discussions and negotiations (Risse-Kappan, 1995; Milner, 1997). With a few important exceptions (e.g. Katzenstein, 1976; Ikenberry, 1988b; Burley, 1993; Vogel, 1995; Raustiala, 1997; Singer, 2004; Farrell, 2006; Newman, 2008a), international relations scholars have neglected how the inward-facing aspects of the state – its domestic regulatory capacities – play an important role in a world where domestic regulation can and does have international consequences.

To understand these interactions, researchers need to expand their theoretical toolbox. First, they need a better account of state preferences – when states or sub-state actors use their domestic regulatory leverage in order to shape international outcomes (or alternatively domestic outcomes that have international repercussions), what will their preferred goals be? While there is important work that seeks to address preference formation, it is, as its authors acknowledge, only a first cut at the problem.[3]

Second, they need to understand better which states (or public actors) will prevail and when – what are the factors that shape states' relative capacity to obtain outcomes when different states have different regulatory goals? The most influential existing work on this topic emphasizes cases where there is either a single regulatory hegemon or where agreements must be ratified in national parliaments (Oatley and Nabors, 1998; Simmons, 2001). However, it is increasingly the case that powerful actors compete to set the rules of international market regulation and they do this without the formal consent of national legislatures.

In this special issue, we look to an existing approach within comparative politics – historical institutionalism – for conceptual tools that can readily be adapted to meet these theoretical needs. Our work thus builds on an earlier generation of research by scholars such as John Ikenberry, Peter Katzenstein, and Stephen Krasner (Katzenstein, 1976; Krasner, 1984; Ikenberry, 1988a, 1988b) on how differences in state capacity may shape international outcomes. In international relations this body of literature petered out, but in comparative politics it instead became the seedbed of a variety of approaches that examine the relationships between state, economy and society, most prominently including historical institutionalism.

Historical institutionalism offers a perspective that stresses the importance of time and timing in causal processes, recognizing both the constitutive nature of institutional contexts and the critical role of unanticipated consequences in driving future policy change. While the international relations literature has drawn extensively on rational choice accounts of how domestic institutions affect international outcomes, these arguments often focus either on a narrow set of rules governing choice in legislatures or legislative–executive relations, or on the 'agency slack' created when legislatures or executives delegate authority under set conditions (Ballmann *et al.*, 2002; Pollack, 2003; Nielson and Tierney, 2003). They thus provide important insights into how *static* sets of rules governing legislative choice or delegation may have substantial international consequences.

Historical institutionalism, by contrast, provides us with a sophisticated account of how public policy institutions (e.g. banking oversight or environmental protection) influence responses to unexpected policy challenges. It helps us to understand the circumstances under which states may easily address these new challenges (when they have previously existing institutions that are easily adapted to meet new needs), and the circumstances under which states have great difficulty in adapting over the short or medium term. In short, historical institutionalism fills a major gap in international relations theory: it sets out mechanisms that explain how actors respond to a changing environment.[4] In particular, this special issue examines two of these mechanisms – feedbacks and sequencing – to parse the political dynamics of international market regulation.

We and our co-authors make two important contributions. First, we more precisely conceptualize the role of international market regulation, which encompasses issues discussed in an increasing number of discrete sector studies (e.g. Raustiala, 1997; Shaffer, 2000; Glimstedt, 2001; Farrell, 2003; Young, 2003; Ansell and Vogel, 2006) but lacks a coherent overall framework to integrate empirical analysis. Second, we lay out conceptual tools that will allow international relations scholars to understand better these relationships and their likely consequences for political-economic phenomena. And at the same time, we make our own contribution to this theoretic toolkit, by showing how historical institutional understandings of domestic institutional trajectories can be supplemented and extended by applying them to cross-national issues.

In the next section of this introduction, we discuss the problems of international market regulation in more detail. In the subsequent section, we discuss how mechanisms identified by historical institutionalists – feedbacks and sequencing – allow us to make claims about the *preferences* that actors (including states) are likely to have over international market regulation, how regulatory *capacities* are built up over time and thus help us to explain *bargaining outcomes* between states and between regulatory authorities.

INTERNATIONAL MARKET REGULATION

The concept of international market regulation allows us better to come to grips with the international implications of national regulatory structures. Such structures have been understudied in international relations theory but are becoming increasingly important for the international economy, in part because of the very success of successive rounds of trade liberalization. As official tariffs have reached their lowest levels in decades, they have correspondingly come to have less influence on economic behavior. Nevertheless, research on 'missing trade' shows that border effects continue to impose tremendous transaction costs on international economic actors (McCallum, 1995; Trefler, 1995). Differences in domestic regulations account for a considerable proportion of this effect. High-level government proposals, such as the Transatlantic Economic Marketplace initiative or the Strategic Economic Dialogue, demonstrate how important regulatory tensions are, while difficulties in translating these proposals into action suggest how durable regulatory differences can be (Pollack, 2005).

Such tensions place new pressures on states, which are frequently expected by their populations to protect domestic regulatory bargains, especially when they touch on sensitive normative issues. Indeed, as Suzanne Berger (2000) has argued, the consequences of globalization are best understood not as a progressive undermining of the authority of the state, but as a growing set of challenges to pre-existing political and economic bargains. Globalization in this context is less about the creation of one international market then it is about the interaction and exposure of national markets to one another (Berger, 2000; Weber, 2001; Zysman and Newman, 2006).

The international exposure of such markets raises important coordination problems. Businesses have invested in nationally constructed regulatory systems. While firms often have an interest in international regulatory convergence as a way to minimize the transaction costs associated with multiple rule-sets, each national industry stands to lose the distributional benefits granted in its national market should convergence indeed take place.

However, because of increased cross-border economic flows, national regulatory systems are coming into greater conflict with each other.[5] As markets that were previously national in scope become exposed to other markets in other countries, decisions by domestic regulatory authorities have broader international consequences. National regulators often find that they have to take decisions with extraterritorial consequences if they are to fulfill their publicly set objectives within their own jurisdictions. Different regulatory authorities will unsurprisingly have different priorities, and sometimes even radically incompatible goals. A policy decision taken by one regulator in one national system may have substantial direct or indirect consequences for the ability of other regulators to pursue their objectives in their national markets (Vogel, 1995). International market regulation, then, involves a broadening of the international political economy to a set of economic and social rules (previously confined to the national setting) that govern global market competition.

In addition, international market regulation is creating greater diversity in the ways in which global governance takes place. In a shrinking number of cases, states continue to rely on formal treaties and international organizations. Often, however, states or other actors employ alternative strategies, including the extraterritorial application of national law (Devuyst, 2001; Simmons, 2001; Young, 2003), transgovernmental cooperation among regulators (Slaughter, 2004; Singer, 2004; Damro, 2006; Newman, 2008b), and indirect regulation through private actors (Cutler *et al.*, 1999; Mattli and Büthe, 2003, 2005; Farrell, 2006; Perry and Nolke, 2006; Vogel, 2008).

How does international market regulation reshape domestic and international economic relations? Some international relations scholars who have studied similar coordination problems would predict convergence upon the practices of the most economically powerful. They argue that those states with the largest markets are *ipso facto* in the best position to protect their domestic policy choices most effectively (their markets provide them with direct and indirect leverage), and, where necessary, to impose their preferences on other, weaker states (James and Lake, 1989; Shambaugh, 1996; Simmons, 2001; Drezner, 2004, 2007).

Daniel Drezner (2007), in his book *All Politics is Global: Explaining International Regulatory Regimes*, sets out what is perhaps the most sophisticated version of this argument. First, building on the work of David

Vogel, Drezner argues that large markets are likely to attract producers who want market access, and who are therefore willing to conform to the standards set for that market. Second, states with large markets are less vulnerable to threats of disruption, and better able to threaten others with economic coercion. Drezner concludes that the key determinant of international regulatory outcomes will be the constellation of great power preferences. Where great powers (in the current international arena, the US and European Union (EU)) agree, then they will be able to set a standard that other smaller states will conform to. Where they disagree, we will see conflicting standards set by great states, around which different coalitions of smaller states are likely to converge.

These arguments provide a good starting point for understanding the role of market power in the international economy. However, recent studies suggest their limits; while large internal markets are a *necessary* condition for bargaining leverage under most political constellations, they are certainly not a *sufficient* condition. Indeed, there is cross-sectoral empirical evidence suggesting that powerful states with large markets, such as the US may lose out under some constellations, so that US domestic actors have to adapt their domestic bargains to make them more compatible with the bargains of other states. To take a few examples from the recent literature: US efforts to outlaw internet gambling are likely to fail when other states allow gambling operations to set up within their jurisdiction, and to market their services to US citizens (Farrell, 2006). Domestic financial regulators may find themselves forced to revise their policies, and to strike informal bargains with foreign authorities in order to effectively regulate their industries (Bach and Newman, 2007; Posner, 2009). Private standards organizations in the US may find that their anarchic domestic institutions are a serious hindrance vis-à-vis their European competitors when standard-setting becomes internationalized (Mattli and Büthe, 2003). This research suggests what is missing from Drezner's account – a discussion of how the presence or absence of appropriate domestic institutions is crucial to explaining states' ability to leverage their market power. It is precisely here that the inward-facing aspects of the state count the most. Those states that have developed sufficient regulatory capacity are able to utilize their market power to affect outcomes, while those that do not have such capacity are disadvantaged in comparative terms.

International market regulation thus provides a unique jumping off point to consider the concrete and material impact of globalization, and how increasing interdependence between states shapes national and international politics in ways that sometimes are difficult to capture using existing theories. It also provides a fertile test-bed for theory building and testing. How are actors – whether state actors or economic actors – likely to respond to the challenges of regulatory interdependence? How will state actors and interest groups align to protect, or not to protect, existing social bargains? What means will these various actors be likely to employ? By studying international market regulation, we can offer useful answers to these questions in issue areas that offer a high degree of variation across arenas of international cooperation and contestation, encompassing not only more conventional inter-state negotiations, but also transgovernmental networks, private actor governance, and extraterritorial extensions of national law.

THEORIES OF DOMESTIC INSTITUTIONS IN INTERNATIONAL RELATIONS – ADDING A TEMPORAL DIMENSION

How exactly *do* domestic institutions shape international outcomes? We have seen renewed attention paid to this question in the wake of the difficulties that Cold War systemic theories have had in explaining many observed outcomes in international politics. International relations scholarship in general and political economy in particular has sought to explore how domestic factors shape states' negotiating positions. Typically, this work starts from a broad rational choice perspective, in which the preferences of domestic actors serve as both a constraint and a source of strength for state negotiators (Putnam, 1988; Evans *et al.*, 1993). More recently, scholars in this tradition have sought to explore the role that domestic institutions may play in channeling these preferences (Milner, 1997, 1998).

This literature has made substantial contributions to our understanding of the relationship between domestic and international arenas, illuminating major empirical phenomena such as trade liberalization, regional economic integration, and financial market globalization (Rogowski, 1989; Moravcsik, 1997; Frieden, 1991). Yet there is good reason to believe that the very construction of these arguments leave important empirical puzzles unexplored or unexplained, particularly in the area of international market regulation. This literature's account of the key causal factors – institutions, preferences and information – focuses primarily on how formal political institutions allocate decision-making power between the legislative and executive branches, giving little consideration to broader institutions such as public policy regimes. Furthermore, its account of outcomes focuses nearly exclusively on formal inter-state negotiations.[6] Such negotiations continue to matter – but their role in the international economy is decreasing as a variety of more complex forms of bargaining and adjustment between states, semi-independent regulatory authorities and private actors emerge.

We argue that the burgeoning historical institutionalist literature in comparative politics, and American political developments in US politics, provide us with a set of tools that will shed light on several of the key outstanding puzzles highlighted above. These tools have, with a few important exceptions,[7] been surprisingly under-employed in international relations debates. We focus on two specific mechanisms – policy feedback processes and relative temporal sequencing – and how they affect regulatory capacity by shaping states' preferences over outcomes and their institutionally determined fallback payoffs in direct and indirect bargaining situations. Underlying our approach is an interest in a broader set of institutions than those currently emphasized in international relations scholarship. We do not confine our studies to the formal political institutions governing legislative choices. Instead, we are explicitly interested in the wider set of institutions that structure public policy regimes. This set naturally includes systems of regulatory oversight, policy rules that define market competition, and state systems of interest aggregation and mediation.[8]

The historical institutionalist approach, in its earliest form, began from the premise that institutions shaped not only actors' strategies but also their goals, and that (a) institutions tend to be sticky over time, but (b) that a theory of institutional 'dynamism' was necessary as a corrective to overly static approaches (Thelen and Steinmo, 1992). Its core problematic has thus always been to explain the relationship between stability and change; how institutions structure the resources and interests of actors as they face changes in *external* political processes, and explaining the resultant political bargains. A second generation of historical institutionalism invoked the notion of path dependence to understand the circumstances under which institutions will tend to reproduce themselves, and the circumstances under which they will break down so that new paths are chosen (Mahoney, 2000; Pierson, 2000, 2004). However, path dependence, especially if employed in a generic fashion, has its own conceptual deficiencies (Crouch and Farrell, 2004), and may sometimes serve to obscure the actual drivers of broader dynamics of adjustment.

Hence, the most recent generation of work in historical institutionalism has sought specifically to identify the *particular mechanisms* underlying institutional stability and change (such as recent work on institutional layering and conversion e.g. Thelen, 2004; Hacker, 2004; Jackson and Deeg, 2008; for an alternative set of mechanisms, see Farrell and Shalizi, 2010). In this most recent wave of research, historical institutionalism is not a static account but rather offers tools to understand how the characteristics of public policy institutions shape actor behavior, interests, and strategy, especially in moments of environmental uncertainty. To demonstrate the usefulness of this approach, we limit our investigation to two outcomes – state preferences and bargaining strength – within the context of international market regulation.

In the remainder of this short overview, we set out our arguments about domestic institutions in greater depth. First, we show how these arguments provide an account of actor preferences that usefully complements and extends more traditional approaches in the field. Next, we discuss the ways in which domestic institutional factors not only shape the preferences of actors, but also their ability to act successfully upon those preferences. We discuss in succession how the relative sequencing of institutions matters, and how domestic state capacities shape the reversion points that traditional bargaining approaches have focused on. We then argue that detailed qualitative theory-testing, whether it be described as 'process tracing' or 'analytic narratives,' provides a useful means for understanding how these causal relationships are likely to play out in the field of international market regulation (Bates *et al.*, 2000; George and Bennett, 2005). Finally, we discuss the contribution that our arguments make to the literature in international relations and sketch a promissory note for a future research agenda.

Domestic institutions, policy feedbacks, and preference formation

International political economists mostly agree that state preferences are the product of domestic politics (Lake, 2009); they disagree over which aspects of politics are most important. One set of scholars have focused on the economic incentives that drive social interests while another have explored how formal political institutions mediate such interests in international negotiations.

Traditional approaches in international political economy have built either on the Stolper-Samuelson or Ricardo-Viner models to illustrate how differences in factor endowments or in the characteristics of specific economic sectors are likely to shape actors' preferences over international outcomes, and hence their willingness to form coalitions supporting or opposing trade liberalization (Rogowski, 1989; Frieden, 1991; Hiscox, 2003). These accounts frequently suggest that state institutions and policies are a simple reflection of the aggregated interests of social actors (Garrett and Lange, 1995; Milner 1997). The problems with this approach have given rise to a second set of perspectives, which seek to incorporate advances in the study of American and comparative politics into international relations theory. Thus, for example, Helen Milner (1997) provides an account of how both preferences and institutions matter for the legislative–executive relationship, and hence international cooperation. More generally, Moravcsik (1997) privileges preferences in his account of international politics but notes that institutions may have significant consequences for whose preferences are expressed.

This second set of accounts is a substantial improvement on the first, in that it allows us to understand how institutions may shape the ways in which pre-existing constellations of preferences are expressed. However, precisely because it takes these preferences as pre-existing, it fails to provide us with any understanding of a key set of causal relationships – how different forms of state institution may not only shape the way in which social preferences are expressed, but may also *shape those preferences themselves*. Thus, for example, Moravcsik (1997: 517) claims that the demands of individuals and groups within society should be treated as 'analytically prior to politics'. Although he occasionally suggests that politics may create feedback loops to preferences, this claim is difficult to reconcile with his ontological priors. Milner argues that state actors seek to maximize the chance of re-election, and are thus likely to be responsive to the demands of social groups, whose preferences over cooperation are an exogenous product of the distributional consequences that cooperation would have.

These simplifications surely have analytic merit for exploring certain kinds of problems, but they also mean that a vast array of potentially important causal relationships go unexplored. Rational choice pluralist approaches, even those that explicitly theorize the intermediating role of institutions have enormous difficulty in endogenizing preference change, precisely because they see institutions as channeling preferences rather than shaping them.

We argue that historical institutionalism provides us with tools we need to construct an alternative (and, perhaps in part, complementary) basis for understanding where state preferences come from. Unlike classic accounts of foreign policy making, this account does not insulate state preferences from societal interests, but it also does not *reduce* state preferences to those of societal groups. Instead, it focuses on one classic mechanism of policy feedback – the propensity of state institutional reforms to create client groups that then have a strong incentive to push for their maintenance. We first review the comparative literature on feedbacks before translating the concept to issues of international market regulation.

Paul Pierson (1993) provides a comprehensive overview of the relevant literature, identifying how institutional change alters the resources *and* the goals of groups in society. Policy change creates incentives for these groups to organize around new concentrated interests, and offers them the tools to press for the expansion of these interests in public policy. Theda Skocpol (1992), for example, documents how laws governing pensions for Civil War veterans encouraged previously dispersed individual veterans to form political organizations. This created a feedback loop in which these newly organized groups lobbied for institutional reforms that extended their role as dominant players, often allowing them to press over time for further concessions.

The field of social policy is rich with examples of feedback processes in areas ranging from pension reform to education policy (Mettler, 2002; Campbell, 2003). Thus, institutions may create well-organized groups of beneficiaries who are highly informed about the possible consequences of institutional change, and likely to oppose it when it potentially undermines their interests (Pierson, 1996; Mettler, 2002). Furthermore, such interest groups may come to be embedded in the decision-making processes of the relevant regulatory authorities, so that these interest groups effectively become co-policy-makers, helping to set the rules of market governance. This is well documented and understood in corporatist systems, but often occurs in purportedly pluralist political systems such as the US too. When embedded, these groups are likely to push for the expansion of the scope of those institutions and policies that provide targeted benefits for their members.

These feedback loops help us to understand how state institutions and social preferences are implicated in each other, and how feedbacks from the state shape the preferences of social actors. They also help us understand how the 'organizational cultures' that shape preferences over international policies arise (Legro, 1997). In matters of economic policy at least, they will typically be the result of mutually re-enforcing interactions between bureaucrats and the social groups who are the main beneficiaries of their policies. Finally, feedback loops of this kind are very difficult to accommodate in traditional rational choice pluralist accounts of interests and institutions, because they suggest that preference formation and institution creation are deeply and immutably intertwined.

Here, our account has some features in common with constructivist accounts of preference formation. Like constructivists, we do not treat preferences as constant or as the determinate product of exogenous forces (whether those forces be domestic political or economic cleavages or features of the international system). However, our account differs from that of constructivists such as Mark Blyth (2002). While we agree with Blyth that preferences are formed in an environment of uncertainty and unexpected shocks, our account privileges previously existing institutional structures rather than ideas as the key factor shaping responses to these shocks.

Together, these arguments allow international relations scholars to build on a broad existing literature, which demonstrates that policy feedback loops are crucial to explaining where state and regulatory authority preferences come from in the first place. Thus, our approach helps correct the bias towards linear explanations that David Lake (2009: 232) and others identify. It offers important insights into the preferences both of states and (if we disaggregate the state) of state agencies, and points to a logic of actor preferences in which interests and preferences are not the result of exogenous economic factors, but rather of previous trajectories of institutional change and group formation in which the state itself is deeply implicated.

Historical institutionalists have few means of predicting when feedback loops will occur *ex ante*; indeed their arguments suggest that they are likely by nature to be unpredictable. What they do is to point *ex post* to factors explaining state and regulatory authority preferences that are systematically under-explored in international relations theory, and that help us understand why they adopt the positions that they adopt over issues of international market regulation.

Specifically, we may predict that where policy feedback loops have occurred, variation in states' preferences over existing institutional bargains will depend on which interest groups have succeeded in becoming embedded in the relevant regulatory decision making structures. Those interest groups that have succeeded in embedding themselves within the relevant institutional frameworks will unsurprisingly use their advantageous position to pursue regulatory policies that favor them (and potentially disfavor other groups). Such interest groups are likely, precisely by virtue of their privileged position, to have previously crafted forms of domestic regulation that suit them well, and that they will be unwilling to change (Fioretos, 2001, forthcoming).

In other words, we argue that interest groups and state preferences have typically co-constituted each other over time, so that states have helped create interest groups, which in turn come to shape state policy in specific directions. Thus, we may also predict that international regulatory convergence will be much less likely to occur or take on traditional forms of cooperation in sectors of activity where the relevant interest groups have managed to embed themselves deeply in the relevant domestic regulatory structures, than in areas where regulators are relatively independent of the interest groups that they regulate.

This may explain why many of the most important domestic institutional changes consequent on globalization have involved institutions that do not have strong interest groups embedded within them. For example, even while monetary policy has vastly important and differential consequences for a variety of interests, relevant interest groups have failed for the most part to embed themselves in central bank decision-making structures over monetary policy. This has facilitated the moves towards increased central bank independence in setting monetary policy that have taken place in most advanced industrialized democracies over the last two decades, and the creation of international institutions such as the European Central Bank. In contrast, there has been far less harmonization of arrangements for central bank supervision of domestic banking structures; the latter have interest groups that not only are strongly vested in the current system, but in extreme cases effectively run it. Where cooperation has occurred, it has relied on transgovernmental networks such as the Basel Committee and the new G20 Financial Stability Board, which reinforce the role of national supervisors and their respective constituencies within the supervision process.

This furthermore helps us understand *which* interest groups prevail in setting national regulatory goals in situations of interdependence. Those interest groups that have become embedded within the relevant regulatory structures through various forms of policy feedback will be able to prevail against other interest groups in setting regulatory policy. There is substantial differentiation in the degree to which these interest groups have become embedded within structures both within and between states.

For example, the US Department of Commerce plays an important role in coordinating the US response to many third country regulatory initiatives. It has typically been highly responsive to the US business community, going back and forth to key business interlocutors to determine whether proposed regulations are acceptable or unacceptable, but has shown little interest in engaging with other concerned parties, such as consumer groups. In contrast, the European Commission, which has its institutional origins in a quite different set of feedback loops, is obliged to consult with a variety of interested parties while preparing its responses to other countries' regulatory initiatives; while business interests typically have more clout than other interests, the latter still play an important role in shaping the Commission's regulatory preferences (Wallace and Young, 2001).

RELATIVE SEQUENCING AND STATE POLICY CHOICES

Historical institutionalism not only provides the basis for arguments about where actors' preferences come from, but also about how domestic institutions are likely to shape the international interactions in which states (and other actors) seek to realize their preferences in informal or semi-formal bargains between domestic regulators or in other forums. Institutions may not only shape preferences but the power of actors to make those preferences stick. Most particularly, domestic institutions are likely to have important *sequencing* effects on international outcomes.

Here we build on key findings of the historical institutionalist literature. As Kathleen Thelen has demonstrated at length, the political needs that institutions were created to meet may be very different from the needs that they are pressed to meet at a later historical juncture (Thelen, 2004). Thelen shows this with regard to the German vocational training system over a period of more than a century, but similar processes can be observed in the wake of globalization. Regulators that had previously sought to govern domestic markets in isolation may find themselves unexpectedly having either to extend their effective reach beyond their home jurisdiction, or to prevent regulatory incursions from external actors. Even so, institutions are difficult to eliminate after mechanisms of self-reproduction take hold. In the short term at least, they present strong constraints and limited opportunities for political actors. This means that at any particular moment political actors' ability to adapt to a changing environment will be shaped, at least in part by previous institutional choices, which may have been taken without any cognizance of what their later historical consequences would have been. Earlier decisions lay out the palette of policy instruments that actors employ as they confront the challenges of the day. [9]

This has particular relevance when we look at the sequencing of two key events: (a) the construction (or lack of construction) of domestic policy agencies in given sectors; and (b) the transition from a world of mostly autonomous national economies to a world of economic and financial interdependence from the mid-1980s onward. The sequence in which these events take place is important. Countries and polities which had built substantial domestic regulatory authorities prior to the advent of interdependence, or in its early stages, are in a very different position from countries which sought to build them afterwards (Newman, 2008a).

For example, states which, for whatever reason, have not developed regulatory capacity in a given sector of market governance before the advent of economic interdependence, are likely to find themselves disadvantaged in international disagreements over this sector afterwards. Lacking expertise and control over their domestic market, states are unable to evaluate the relevant international policy alternatives, and to push for those that best meet their interests. Nor – even in circumstances where developing this expertise is an urgent necessity – is it easy for collective actors such as states to develop it in short order. The difficulties that they would face in any event in building such regulatory arrangements are greatly compounded by interdependence. Domestic firms and other actors that are exposed to international markets are likely to have already converged on the preferences of other states with powerful ready-made regulatory capacities. Furthermore, international institutions, where they exist, are likely to reflect the interests of the latter states rather than the former, and thus to constrain domestic policy choices.[10] In contrast, states which had already, for historical reasons, created regulatory institutions at an earlier juncture, are likely to find it much easier to locate the necessary expertise and apply it as appropriate.[11]

Thus, for example, the Securities and Exchange Commission (SEC), born in the 1930s as part of a domestic policy initiative to shore up confidence in national markets, has played an instrumental role in US dominance in international financial services regulation.[12] The lack of such expertise in many European countries until the mid-1990s severely hampered the region's ability to offer an alternative to US hegemony in the sector. While the Europeans have built up institutions in the interim period, these institutions very often reflect American notions of regulation that many European market actors had previously adapted to. Thus, sequencing was important – had the Europeans constructed financial services regulators at an earlier stage, they would have likely made very different domestic choices, and been able to exert greater bargaining strength later on issues where they disagreed with the US. Conversely, the US was incapable of preventing the diffusion of European privacy rules that clashed with its strong preference for market-based solutions. The Europeans, who had over 30 years of experience in privacy regulation, successfully negotiated an exemption for privacy rules in the General Agreement on Trade and Services. The US, which had foregone the opportunity to build up a domestic regulatory structure in the 1970s, did not understand the international ramifications of the exemption. By the time national firms protested the protectionist implications of these rules, the international trade regime had been eliminated as a viable platform for negotiations (Newman, 2008a).

Integrating these temporal effects into the international political economy furthermore shows new causal possibilities above and beyond those identified by comparativist historical institutionalists, by showing that the mutual embroilment of different national economies creates the possibility of cross-border *relative sequencing effects*.

Here, our account above provides an alternative view to that of comparativists, who have stressed variation in the sequencing of *internal events* to explain differences in national outcomes (e.g. focusing on how the timing of civil service reforms affects the relative levels of political party clientelism in different countries, Shefter, 1977). At the international level, however, events in one country may be entrained in sequence with events in another. We argue that the timing of an institutional development in one country relative to the same development in another country will alter both countries' international bargaining strength.[13] We may expect the importance of cross-national interactive sequencing events to increase as domestic markets come to interpenetrate each other ever more. This is to say that a country's choices at time *t* will not only be determined by previous institutional choices made within that country at time *t-1*, but also by institutional choices made in *other countries* at time *t-1*. Some institutional choices that might otherwise have been possible will be ruled out by choices made in different countries whose rule systems interpenetrate with the rule system of the state in question. Similarly, domestic policy decisions in one country might have dramatic and unanticipated consequences for its relationship with other countries in later periods.

We acknowledge that our arguments provide clearer predictions in the short and medium terms than in the long run. Over the longer term 'second image reversed' effects are likely to play a role, so that, relative institutional asymmetries at the international level lead to endogenous domestic change processes that in turn may reshape international positions. Thus first mover advantages do not guarantee permanent hegemony. SEC dominance of international financial securities regulation for much of the 1970s and 1980s no doubt contributed to the transformation of internal European governance in the sector (see Posner, this issue).

Hence, our explanatory framework has limits. However, it also uncovers features of institutional development that other approaches leave out, showing how the responses of states to apparent disadvantage are themselves conditioned on both domestic and international forms of sequencing. This may sometimes have unfortunate results – if we look more closely at the European regulatory changes discussed by Posner (this issue), we see that they were conditioned by the lagged build up of regulatory capacity. European regulators thus find themselves with arms-length oversight capacities typical of regulatory state strategies of the 1990s, which may not be well suited to the new statist strategies being promoted to resolve the global financial crisis.

This kind of effect is discounted by both comparativists (who typically treat countries as independent cases) and scholars of international political economy (who have paid little attention to temporal mechanisms such as sequencing). But as national markets become ever more interpenetrated, such mechanisms are likely to become increasingly important.

Finally, in addition to the historically contingent presence or absence of institutional capacity, negotiating strength is conditioned on the character of domestic institutional configurations that affect preference expression. States or national political systems that lack appropriate institutions to disseminate information on pending international decisions widely may find themselves disadvantaged with regard to states that have such institutions. For example, Walter Mattli and Tim Büthe (2003) find that US standards organizations face systematic disadvantages vis-à-vis their European equivalents in shaping international standards. US organizations tend to be fragmented, and to have a patchy record in supplying information to their broader constituencies. European organizations, in contrast, have mechanisms that allow them to coordinate the positions of various national level organizations, and are able to communicate more widely and effectively on proposed new standards. The result is that US standards organizations find themselves in second-mover rather than first-mover position. Given the increasing importance of international standards, one might reasonably predict that US businesses would push for a coordinated structure along European lines in order to maximize their international clout if they had a clean slate to start from. However, given the existence of a variety of competing revenue-driven domestic standards organizations within the US which date from an era where the national arena was more important to business than the international one, it is very difficult to create such an overarching structure.

In short, sequencing matters. States and other actors find themselves bound, at least in the short to medium term, by prior institutional choices, which may have seemed entirely innocent of international consequences at the time of their origin. These domestic choices intersect with choices in other states in ways that have substantial international knock-on effects, by alternatively constraining states or enabling them.

In many situations, the mechanisms of institutional preference generation and sequencing are likely to work in the same direction, so that their causal impact is commingled. Thus, one might easily imagine that the preferences that states hold, and the sequencing effects that allow states to pursue those preferences will often reinforce each other, leading states to pursue international outcomes both because these outcomes are consonant with institution-generated preferences (there are influential organizations which have a stake in them) and because they are the best available options to states given the way that these prior institutions constrain choices. However, there are also circumstances under which they may point in different ways, e.g. because in a given *ex post* situation, a given state or other actor might prefer to have different options available to it internationally than those that are available to it domestically.

REGULATORY CAPACITY AND INTERNATIONAL DISPUTES

As the existing rational choice literature argues the *reversion point* – the character of the status quo in the absence of successful coordination – is a key factor influencing the bargaining strength of states (Richards, 1999; Gruber, 2000). We do not take issue here with the basic bargaining framework that these scholars put forward; instead, we seek to fill gaps in their accounts by showing how states' and regulators' domestic institutions may also affect their fallback options and thus their reversion points. Standard game theory suggests that when states are bargaining with each other over which of a spectrum of mutually acceptable outcomes should be chosen, the breakdown values, or the outcomes which will transpire in the absence of agreement, will affect their relative bargaining strength. We argue that in issues of international market regulation, the breakdown values will be powerfully shaped not only by natural endowments but also by existing domestic institutional structures. First, we argue that states which are relatively well-able to regulate using their domestic institutional structures alone in the case of breakdown will be in a stronger bargaining position than states which will find their domestic institutional structures undermined or ineffective if breakdown occurs.[14] Second, we argue that the sequencing effects we identified previously means that it will be difficult for states to change their domestic structures in the short to medium term so as to improve their bargaining position.

A recent illustration of this mechanism can be found in EU–US disputes over airline passenger data (Farrell, 2006; Newman 2008a). States have increasingly found that their regulatory structures governing security in the air transport sector are interacting with each other. While EU law apparently forbade airlines from sharing passenger data with US authorities, US law required these airlines to provide information. This led to negotiations between EU and US authorities, but negotiations that occurred in the shadow of domestic institutional structures. As EU policy-makers admitted, airlines had decided that they would cooperate with US authorities rather than EU ones in the case that negotiations broke down – they had concluded that the US was more likely to exact stringent penalties given its domestic institutional structures than the EU was. This left the EU in a relatively weak bargaining position, in which it had little leverage over the US, and was forced ultimately to accede to an agreement in which the EU made substantial concessions to the US. Had the US not developed a set of stringent sanctions building on a long-standing set of domestic institutions governing airlines, we might have expected a very different outcome.

By the same logic, where breakdown does occur, domestic institutions are likely to play an important role. Previous work suggests that where states have incompatible preferences, the probable result (in the absence of war) is deadlock between them (Moravcsik, 1993). The version of historical institutionalism that we employ here suggests that states have options beyond stalemate – they may seek to use domestic institutions to shape the international regulatory lowest common denominator that transpires in the absence of agreement. In other words, states may use domestic institutions to externalize their national rules globally. The extra-territorial knock-on consequences of domestic rules fundamentally shift the strategic position of market players. In areas such as competition policy, financial services regulation, and data privacy, the US and Europe have extended the reach of their national laws, shifting the international regulatory reversion point.

METHODOLOGY

How should the causal relationships that govern preference formation and bargaining strength be studied? Here, we follow Kathleen Thelen, Paul Pierson and other prominent comparativists who have employed case studies, qualitative methods and process tracing as means of understanding institutional stability and change. We argue that these methods are appropriate to uncovering the causal factors implicated in our account for two reasons. First, they allow one to disentangle relationships in complex contexts where traditional statistical data are difficult to acquire and/or analyze. Second, qualitative tools are easier to reconcile with our ontological assumptions than are statistical techniques.

As Andrew Bennett and Colin Elman (2007) have argued, qualitative and case study methods have a long history in international relations theory and most particularly in international political economy (Büthe, 2002; Odell, 2004). The reasons for this are straightforward; many of the most important topics for international relations scholars involve highly complex causal relationships, with multitudes of interaction effects, and low numbers of cases, where statistical techniques are difficult to apply. Bennett and Elman (2007: 171) argue that 'the complexity of IR and the ubiquity of phenomena that are in many respects are sui generis, thus [rendering] many puzzles in IR difficult to model formally and to test statistically'. In many instances, correlations are apparent but competing claims about mechanisms persist. Second, scholars such as Peter Hall (2003) argue that process tracing and case studies methodologies are especially well suited to studying the *particular* causal mechanisms that historical institutionalists (and indeed scholars seeking to derive predictions from many kinds of game theoretic models) invoke than multiple regression models and their methodological cousins.

None of this is to say that some statistical methodologies might not help elucidate the kinds of mechanisms that we discuss in this article (indeed, see Mosley in this special issue). It is to say that initial theory building investigations – such as the one we are undertaking here – are better served by finding specific evidence that the mechanisms we identify are at work, than by seeking to extend these results through (for example) using statistical models to explore change over time, diffusion, etc.

Structured historical narratives, then, are well suited to tease out through process tracing evidence for or against a particular causal pathway. However, case study methods face their own methodological challenges. In particular, critics argue that they are sometimes unrigorous, and that they are often unconnected to each other and to the previous literature so that their contribution to cumulative knowledge is uncertain.

In this special issue, following Bennett and Elman (2007), we seek to address these potential problems by specifying a clear set of causal mechanisms to be investigated across several cases. This allows us to make a cumulative and coherent contribution to the literature. The cases have been selected with two goals in mind. We seek to discover whether our arguments have traction and provide new insights regarding phenomena that have previously received extensive discussion in the literature. Thus, three of the contributions address the relationship between the European Union and the United States, perhaps the most widely studied bilateral relationship in international political economy,[15] while making very different arguments than existing work about the factors shaping this relationship. If our arguments about international market regulation and the importance of domestic institutions hold, then we may expect both that preferences will be shaped by domestic institutional legacies and that variation in international bargaining outcomes will be less a function of traditional measures of market power, than of how that power can or cannot be leveraged through the institutional repertoires that the EU and US possess in different areas of market regulation.

Posner provides an important revisionist account of the evolution of global accounting standards, a subject that is both politically topical and the subject of much recent academic attention. He shows that one simply cannot understand how these standards emerged without paying attention to the sequencing of institutional developments on both sides of the Atlantic. US efforts to propagate its own domestic standards gave way to a focus on international standards as the EU developed its own regulatory capacities, leading to a final agreed approach which would not have arisen had institutions developed in a different temporal order. Cross-border sequencing effects have received little attention in either international relations or comparative political economy, but have profound implications for both.

Bach and Newman provide a cross-sectional and cross-temporal comparison of standards regulation in cosmetics and pharmaceuticals to examine the relationship between domestic institutional capacities and patterns of cooperation and bargaining power. Liberals would predict that these standards would be dictated by the functional needs of the EU, US and other countries, while realists would contend that relative market size would dictate bargaining power, and hence tell us which state's regulatory preferences would win out. However, comparison over time and space shows that neither account is sufficient to explain the form of cooperation or influence over the content contained in such rules. The relative sequencing of domestic regulatory capacities of the EU and US over time provide a much better account of observed outcomes and underscore the importance of national public policy decisions for global governance.

Fioretos focuses on the mechanism of preference formation, asking why different states had quite different preferences over whether and how hedge funds should be regulated. Drawing on arguments from the 'varieties of capitalism' literature in comparative political economy, he finds that state preferences were shaped by the back and forth between domestic interest groups and regulators with some surprising results. Even though the US has a larger hedge fund sector than the UK, it was more willing to compromise with states that wished to see funds regulated, in large part because of institutional feedbacks within the regulatory apparatus that consolidated the interests of shareholders as well as the funds themselves.

The final two articles by Sell and Mosley focus on global regulatory relations, paying particular attention to relationships between countries in the developed world and in the global South. On the one hand, they make it clear that the mechanisms emphasized by historical institutionalism have substantial purchase on these relations too. On the other hand, they point to the need to supplement these mechanisms with a focus on diffusion and compliance. In many respects, these countries are 'takers' not 'makers' of regulation (although this may be changing), which means that it is important to understand the circumstances under which they do or do not comply with global standards, and under which they do or do not seek to recreate domestic institutional capacities.

Mosley examines the politics of compliance with global standards in middle-income countries. The author finds that these countries frequently do not implement these standards, and that standard 'external factor' explanations such as the role of the International Monetary Fund (IMF) and competitive pressures with neighboring countries fail to sufficiently explain variation. Instead, she finds good quantitative and qualitative evidence to suggest that internal features of the state driven by institutional feedbacks are highly important; e.g. countries where the state and banking system are closely interconnected with each other are unlikely to comply with standards that might lead to greater competition in the financial sector.

Sell's article provides a detailed synthetic explanation of preference formation, bargaining power and diffusion of institutional forms in the area of intellectual property. She uses a detailed reconstruction of history to show how interest groups shaped regulatory authority and regulator authority shaped interest groups in making intellectual property protection a major US goal. She then goes on to show how domestic institutions (and in particular the possibility of unilateral punishment) enhanced US bargaining power against countries in the developing world, leading even the stronger ones to accept the incorporation of intellectual property protections in the World Trade Organization. Finally, she examines the politics of institutional diffusion, arguing that historical institutionalism is only partially equipped to grasp some forms of structural power in the international system.

CONCLUSIONS

Recent research on the nexus between national and international affairs has elevated scholars' attention to such concerns. By disaggregating the state, this literature has nuanced our understanding of state preferences and international bargaining outcomes. This same literature, however, has tended to draw nearly exclusively on rational choice institutionalism, limiting the scope of such investigations. By incorporating historical institutional tools into the discussion, we hope to broaden the debate about how, why, and which domestic institutions matter for a broad range of international relations topics, e.g. regime formation and change, international negotiations, transgovernmental politics, private actor authority, and the interaction between states and international organizations. We also hope to broaden our understanding of the kinds of institutions that are important to explaining outcomes, including policy institutions as well as the institutions of legislative choice that international relations scholars more usually invoke. The primary goal of the special issue, then, is to develop a set of appropriate tools for understanding these relationships.

This introduction outlines a promissory note on a research agenda that in the first instance will be fulfilled by the following articles. Future work will be necessary to scrutinize the hypotheses we derive as well as examine a number of natural extensions. For example, the historical institutional literature has increasingly recognized the importance of informal institutions within temporal developments (Helmke and Levitsky, 2004). While such institutions are not the focus of the mechanisms identified in the introduction, we believe this would be an important next step. Informal modes of economic governance (e.g. small firm cooperation in Italy, *keiretsu* in Japan, firm cartels in Germany) are an important characteristic of many system of economic production, and a key source of economic advantage. By explicitly theorizing how states seek to protect these domestic arrangements, we may understand a variety of disputes (e.g. trade disputes between Japan and the US in the 1990s, disputes over government procurement, etc.) that are at the heart of debates in international political economy, but are quite poorly understood (Johnson *et al*., 1989).

Additionally, work on the varieties of capitalism and other historical institutional phenomena have highlighted the role of interlocking institutional complementarities. Political institutions do not exist nor are they developed in a vacuum. Rather, they function in concert with other preexisting mechanisms (Amable, 2000; Boyer, 2005; Deeg, 2007). The institutional mix, both domestically and between domestic and international organizations, may have an effect on state behavior that is more than the sum of its individual parts. In trade policy, for example, the relationship between the trade negotiator's office and relevant business interests may vary across the varieties of capitalism. In a similar vein, historical institutional research has focused extensively in recent years on the parameters of institutional change. Work on institutional layering, drift, and re-appropriation has highlighted the possibility of innovation and change over the historical long term (Thelen and Streeck, 2005; Hacker, 2004). While we do not seek to develop these mechanisms further in this contribution, concentrating instead on demonstrating the *prima facie* value of historical institutionalist tools for international relations, we contend that they provide the basis for an exciting and innovative new research agenda.

Finally, we argue that by applying insights from historical institutionalism to the international political economy, we cannot only enrich international relations, but drive home the importance of transnational factors for comparative political economy too. By confining their research solely to studies within the nation state, or comparisons between them, comparative historical institutionalists have arguably neglected key mechanisms of institutional change that do not stop at borders. Thus, for example, we argue that cross-national sequencing is likely to play an increasingly important role in explaining domestic institutional change.

We believe this to be an especially important task, given the enormous challenges that face both domestic and international rule systems in the wake of the ongoing crises in global markets. The framework provided in this special issue provides insights regarding just the kinds of regulatory relationships that have been called into question. We may perhaps be on the verge of fundamental ideational and institutional changes in how international markets work. However, our arguments suggest that we should be highly cautious in issuing grand pronouncements about the likelihood of major institutional convergence or divergence. Domestic institutions are very sticky, and even when political actors seek major reforms, they are likely to build on existing domestic structures. Hence, the immediate cross-national reaction to a largely symmetrical international shock may lead to increased divergence rather than convergence in regulation. The difficulties that, for example, the European Union has had in bringing through reformed oversight of European banking markets in the face of entrenched domestic interest groups suggests that our account is plausible, at least on the evidence that is initially available.

Unless the international interdependence of the last two decades is somehow rolled back, we may expect that the politics of international market regulation will resume again in the medium term, albeit from a different starting point. Advanced industrial economies will become more tightly regulated; some may indeed return to a system where control is exercised through state ownership rather than arms-length oversight or market solutions. States in the global South will be less likely to seek to converge on minimal forms of regulation than they were in the past, and more likely to retain extensive domestic forms of regulation which they may, in some cases, be able to back up with greater regulatory capacity.[16] This is likely to lead to increasing tensions between different regulatory systems as the apparent consensus surrounding the benefits of deregulation further unravels. The future of international economic politics is likely one of greater and more overt regulatory conflict. Hence it is crucial that scholars of international relations (and indeed comparative political economy) develop the necessary tools to systematically explore this poorly understood set of relationships.

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NOTES

1 We understand regulation as specific rules, promulgated and enforced by a state, or actors who are recognized by a state or states as legitimate regulators, and intended to govern the behavior of actors in a given area of activity.

2 For a review see Krasner (1984). See Keohane and Nye (2002) for discussion of the complexities of global governance in an interdependent world.

3 For the need for more work on preferences see Frieden (1999). Previous work emphasizing materialist motivations include Rogowski (1989), Frieden (1991), and Hiscox (2003).

4 For a complementary strategy, see recent work adapting sociological insights (Blyth, 2002; Seabrooke, 2006; Jabko, 2006; Widmaier *et al*., 2007; Woll, 2008).

5 This is of course not a new observation to us; it goes back at least to Keohane and Nye (1977). Nonetheless, its implications for the international role of domestic market rules remains under-explored. For a current example see Elbe (2008).

6 A notable exception is Singer (2007), who uses a rationalist approach to examine regulatory preferences for transgovernmental cooperation.

7 The major exceptions that we are aware of are Pierson (1996), Ikenberry (1998a, 2001), Spruyt (1994), Meunier and McNamara (2007), Newman (2008a), Posner (2005) and Raustiala (2004). Fareed Zakaria's (1998) theory of 'state-centered realism' also has many important features in common with historical institutionalism.

8 We are grateful to Paul Pierson for laying out this argument about the differences between legislative institutions and policy institutions.

9 On the importance of sequencing, see Pierson (2004) and Zysman (1994). Evans *et al*., argue that there are 'specific organizational structures the presence (or absence) of which seems critical to the ability of the state authorities to undertake given tasks. In turn, the presence or absence of organizational structures is connected to past state policies, thus underlining the need for historical as well as structural analysis if specific state capacities and incapacities are to be understood' (Evans *et al*., 1985: 351).

10 To keep our argument tractable enough to be published in article form, we do not explicitly seek to build international institutions into our account here, although we note that our claims may easily be extended to include them.

11 At the domestic level see Ziegler (1995).

12 See Simmons (2001). By focusing on public policy regimes, we allow such capacities to vary by sector and time. This overcomes a major limitation of earlier work that identified differences in weak and strong states (Migdal, 1988).

13 This argument layers an interactive systemic component to earlier work on foreign economic policy. See Katzenstein (1976).

14 Here we build on the earlier work of Katzenstein (1976) and Ikenberry (1988).
15 On the importance of the EU–US relationship for issues of international market regulation see Drezner (2007).
16 For the case of China, for example, see Bach *et al*. (2006).

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