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Ideas and interests in global financial governance: comparing German and US preference formation

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Abstract *Financial crises underline the necessity for more effective global governance. Despite the creation of the Basel II Accord, no agreement has been reached on the reform of the International Monetary Fund (IMF). Why do governments only selectively agree to reform global governance? I argue that convergence and divergence of governmental positions cannot be explained solely by the logic of the international system, institutions or globalization. Instead, they strongly reflect domestic ideas and interests. Furthermore, the ability of governments to compromise internationally is influenced by the different impact of domestic ideas and interests. With regard to their prevalence in domestic preference formation, ideas prevail when governance affects lobby groups diffusely and poses fundamental questions on the role of politics in governing the economy. Interests prevail when lobby groups are affected directly and new governance concerns a specific distribution of costs. These arguments are tested on the preference formation of the United States and German governments on the IMF and Basel II.*

Introduction[1]

Economic globalization through cross-border financial flows is only partially matched by political globalization in the form of multilateral rules for global markets. There are some instances of the creation of new political initiatives such as the Basel II Accord and the Financial Stability Forum. At the same time, the political management of financial crises through a reform of the International Monetary Fund (IMF) has not improved substantially. This partial 'globalization of politics' can be considered a drawback, since economic globalization defined as the growing share of cross-border economic activity in total economic output has increased instability in the world economy. This became evident with the number and severity of financial crises, such as those in Latin America and Asia in the 1990s as well as in the financial market crisis in the industrialized world in 2008.

These crises are not restricted to individual countries, but increasingly affect all countries integrated into the world economy. For example, crises in emerging markets not only damaged countries such as Thailand, Indonesia, Argentina and

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Russia which were directly involved, but also industrialized countries in Europe and North America through a selective breakdown of trade, losses for creditor banks and stock exchange turmoil. Although globalization is not necessarily a homogenous force, the governments of those countries that are heavily integrated in the world economy share a common perception of the need for better governance of globalization through more efficient multilateral rules for the prevention and management of financial crises. This common perception is acknowledged by the governments of the most important actors in today's international political economy. Even before the current financial market crisis, key decision makers from industrialized countries, including Germany and the United States (US), stressed the need for better governance, for example:

- US Secretary of State Colin Powell (2001) declared that 'in our increasingly globalized world, America's prosperity and well-being are linked ever more closely to expanding growth and stability worldwide. That is why strong United States leadership in the IMF, the World Bank and the WTO is so crucial to America's future and the world's future'.
- The White House (2006) under President George W Bush stressed in its National Security Strategy, stating, 'In our interconnected world, stable and open financial markets are an essential feature of a prosperous global economy. We will work to improve the stability and openness of markets by ... strengthening international financial institutions'.
- Germany's Chancellor Gerhard Schröder (2002) emphasized the necessity for a new political architecture of the world economy, saying, 'After all, we need a truly democratic trade and financial regime in the world'.
- Germany's Chancellor Angela Merkel (2007) declared at the World Economic Forum in Davos, 'We politicians know these fears [of globalization] well and therefore have to do everything to shape globalization politically. ... We want to minimize the systemic risks of international capital markets ... . We need a coherent, joint action in many international bodies'.

However, this shared perception of the *need* for better global economic governance often does not translate into compatible positions on the *form* of desired new governance. Differing strategies for the design of new rules can be found even between industrialized countries of the Group of Seven (G7). On the governance of financial markets, for example, one can observe divergent preferences between the US and German governments with regard to the reform of the IMF: while the US prefers a restriction of IMF activities to emergencies, Germany wants to expand its programmes as well as its governmental funding (Gamble 2004; Schirm 2004; Helleiner and Momani 2007). Thus the core questions are as follows: why do governmental preferences on new rules for global markets diverge? Why do governments agree on a reform of global economic governance in some cases, but not in others?

The paper is structured as follows. In section two I propose an analytical approach, arguing that national preferences on global economic governance strongly reflect domestic ideas and interests, which influence the ability of governments to compromise internationally. But when do domestic ideas prevail over interests and vice versa? In this regard, I argue that ideas prevail when new governance initiatives affect lobby groups diffusely and concern fundamental questions on the role of politics in governing the economy. Interests prevail when specific lobby groups are affected directly and when new initiatives distribute costs and gains for a specific sector. These arguments are then tested in sections three and four through case studies on the formation of the preferences of the German and US governments on the reform of the IMF and on the Basel II Accord.

Analytical approach: domestic ideas and interests in national preference formation

Research on global economic governance has focused on the international system as the level of analysis and has predominantly investigated questions on the performance of international institutions, on intergovernmental negotiations, on civil society and on the legitimacy of transnational actors (see O'Brian et al 2000; Nye and Donahue 2000; Bird 2003; Kahler and Lake 2003; Scholte 2003; Higgott 2004; Barnett and Duvall 2005; Diehl 2005). National preferences are often derived from the international system; that is, from a neorealist perspective on the international distribution of power or from an institutionalist perspective on the configuration of international rules and expectations. Regarding the methodology and the theoretical approach, many studies focus on institutionalism, constructivism and regime theory (see Onuf 2002; Adler and Bernstein 2005).

I argue that in order to understand the problems in achieving global economic governance, research has to focus more on the domestic sources of preferences of governments. Despite the growing importance of private actors in shaping global governance, national governments remain core actors in this process. Drezner (2003, 36) confirms the gap in research by stressing 'the need to focus more clearly on the origins of great power preferences in the global economy ... What drives the preferences of relevant actors? How can we divine what governments want?' Therefore, this paper intends to answer the questions outlined above with a societal approach to governmental preference formation, complementing the dominant focus in research on regime theory and institutionalism. Following the liberal theory of international relations, I will focus on the influence of domestic politics on governmental preferences on foreign economic policy and on the interaction between globalization and domestic politics (Katzenstein 1978; Putnam 1988; Frieden and Rogowski 1996; Moravcsik 1997; Schirm 2002a, 33–56; Weiss 2003). My core argument is that the divergent positions of governments towards global economic governance and the variation in their ability to compromise on multilateral agreements is strongly influenced by domestic ideas and interests. The argument is based on the assumption that governments in democratic political systems represent dominant societal influences that can range from specific lobby groups to the voters' attitudes. Thus, governmental positions express preferences originating from societal influences prior to international strategies and interstate negotiations. This implies

> that states do not automatically maximize fixed, homogeneous conceptions of security, sovereignty, or wealth per se, as realists and institutionalists tend to assume. Instead ... they pursue particular interpretations and combinations of security, welfare, and sovereignty preferred by powerful domestic groups. (Moravcsik 1997, 519)

In order to understand international behaviour of states it is necessary to first analyse the domestic sources of governmental preferences. For this purpose, I suggest two explanatory variables: because governments want to be re-elected, they are responsive in democracies to the way in which both domestic material *interests* and value-based *ideas* relate to globalization and global governance. Using these variables, this paper addresses recent material changes brought about by globalization and the long-term values of the societies. It differs from most other approaches by including in the analysis two driving forces that are usually employed exclusively. The inclusion of both variables is based on the assumption that individual as well as governmental preferences and actions can be influenced by short-term material considerations, long-term ideas, or by a combination of both. Not only can ideas and interests compete in influencing preferences, but in pluralistic societies different interests and ideas can also compete amongst themselves. In addition, they can interact in a non-competitive way. For example, dominant ideas can reinforce or weaken specific interests and changing interests can trigger a socialization process that can change ideas (on the interaction between ideas and interests see Goldstein and Keohane 1993; Thelen 1999, 379–381). The two variables shall be defined as follows:

- *Interests* are defined as material economic considerations of domestic groups which can alter rapidly according to changing circumstances understood as new benefits and costs induced by globalization and (new) global governance. This definition is based on analyses concerning the interaction of economic internationalization with domestic sectors and politics (Frieden and Rogowski 1996; Moravcsik 1997). Frieden and Rogowski (1996, 35) argue that globalization, understood as 'the exogenous easing of international exchange', leads interest groups to pressurize the government into establishing competitive conditions. Moravcsik (1997, 528) emphasizes that changes in the structure of the domestic and global economy alter the costs and benefits of transnational exchange, creating pressure on governments to facilitate or block such exchanges. Previous research (Schirm 2002a) on comparative country studies confirmed that due to globalization, private interests increasingly take into account transnational economic considerations in influencing governmental preferences. Therefore, this paper focuses on the material impact of globalization and/or (new) global governance in the form of (expected) changes in economic conditions to examine the connection between interests and governmental preferences. This connection can occur, for example, in the form of a company's or a sector's more positive attitude towards further globalization due to a successful competitive position in the world market. Likewise, increasing integration of national economies can trigger opposition towards further integration if jobs and profits are threatened by global competition or (new) governance rules.
- *Ideas* relevant for formulating preferences on global economic governance are defined here as path-dependent and value-based collective expectations on how politics should govern the market. Ideas can express themselves in societal attitudes and, in an institutionalized form in the political culture and system of a country. Changes in ideas and interests can both take place but the former takes longer due to the path-dependent character of ideas. A value-based idea is relevant for the re-election of a government if it possesses high commonality ('is it shared by a large number of citizens?') and specificity ('is its meaning precise?'). The conception of the explanatory variable 'ideas'

is based on previous work on societal norms (Schirm 2002b, 2004) as well as on Moravcsik's (1997) 'ideational liberalism'. In complementing Moravcsik's approach, I differentiate between process ideas and content ideas (Schirm 2004, 12). Ideas relating to political *process* are defined as dominant expectations about the way political decision-making should be conducted and can favour, for example, the inclusion of all relevant societal groups in the form of the idea of 'consensual decision-making', or stress 'majoritarian and competitive decision-making'. Ideas relating to the *content* of politics express what a society sees as a core task of the state in a given policy area. In the economic realm, competing content ideas can be, for example, 'individual responsibility' and 'trust in market forces' versus 'public solidarity' and 'regulating market forces'. As stated earlier, ideas and interests may interact by reinforcing or weakening each other. For example, the intensity with which interests influence governmental positions may depend on the set of ideas on the related issue such as the idea of 'individual responsibility' supporting the material interest in 'liberalization'.

Summing up, the following three questions and hypotheses form the analytical approach and guideline for the empirical research in the case studies:

1. Why do governmental preferences agree on the necessity of global governance but often disagree on its form? If endogenous ideas and/or interests differ between states, then divergent governmental preferences on global governance are to be expected despite a similar perception of the need for a better management of the world economy. It has to be empirically analysed how far the preferences correspond to endogenously dominant, and in cross-country comparison, possibly diverging ideas and/or interests.
2. Why do governments agree on a reform of global financial governance in some cases, but not in others? This general question is specified following the societal approach to preference formation of the paper (and because the intergovernmental negotiation process is not under scrutiny here): which domestic conditions influence the ability of governments to compromise internationally? If differences in material interests between countries dominate governmental preferences, then compromise on new governance through a partition of costs and benefits is more likely than in situations where differences in ideas dominate, which would have to be overcome by consensus-building. This hypothesis seems plausible because of the assumption that different material interests can be settled in an international negotiation process more easily through calculating a mutually acceptable distribution of costs and benefits than can differences in ideas. As the settlement of the latter requires consensus among the differing parties, it seems to be more difficult to achieve on the international stage than domestically because there is no international society that can come to a new consensus on ideas the way national societies can. Societies are increasingly influenced transnationally, but they are still predominantly constituted nationally.
3. Under which conditions do ideas prevail over interests and under which conditions do interests prevail over ideas? When interests are affected directly and distributive questions dominate, then interests will prevail over ideas in shaping governmental preferences. When interests are affected in a diffuse way and fundamental questions about the role of politics in governing the

> economy dominate the debate, then ideas will prevail over interests. The hypothesis seems plausible because, if interests are directly affected with regard to costs then the respective actors and their lobby groups have a strong incentive to influence the government. On the other hand, if interest groups are only affected in a diffuse way and fundamental questions on the political governance of markets dominate the debate, then societal attitudes will be more relevant while interest groups do not have the motivation for intense lobbying. Moravcsik (1997, 529) underlines this point with regard to trade policy: 'Recent research supports the view that protectionist pressure from rent-seeking groups is most intense precisely where distributional concerns of concentrated groups are strongest'.

The analytical framework developed here intends to *complement* other approaches and the explanatory variables 'ideas' and 'interests' should neither be seen as deterministic, nor as exclusive. Other factors might, of course, also influence governmental preferences and their ability to compromise internationally.[2] The argument here is that the focus on international institutions and regimes, on power and negotiations, on the legitimacy of non-governmental actors and on globalization has to be complemented by examining ideas and interests within national societies as foundations for governmental preferences and thus as possible conditions for success and failure in reforming global economic governance.

Operationalization of case studies

In sections three and four, I will briefly give evidence for the explanatory power of the hypotheses in case studies on the preferences of the German and the US governments on a reform of the IMF and on the Basel II Accord between 2001 and 2007. This period encompasses the debate and the negotiations for a reform of both governance institutions starting in the aftermath of the Asian Crisis for the IMF and with the first proposals to substitute Basel I in the end of the 1990s. The two cases were chosen in order to present a variation from successful (Basel II) to unsuccessful (IMF) cooperative situations. Keohane (2002, 252) underlines this point stating:

> To focus only on existing institutions is to select on the dependent variable, giving us no variance and no leverage on our problem. On the contrary, we need to explore situations in which institutions have not been created, despite a widespread belief that if such institutions were created, they would be beneficial.

The countries analysed in both cases are key players: the US and Germany figure among those states with the largest voting quotas (within the IMF) and

[2] I am grateful to an anonymous reviewer for pointing out that alternative explanations of US and German preferences in these two cases include the greater costs associated with the formal commitments (Abbott and Snidal 2000) involved in the IMF negotiations as compared to the Basel negotiations, and the closer association of the former with the overall standing in the international order of the state, a point consistent with realist theory. An exploration of these alternative explanations goes beyond the scope of this article. It can be noted, however, that one would expect evidence of these explanations to show up in the statements of officials and no such evidence was found.

influence (Basel Committee) as well as open ambitions to reform both institutions. An inclusion of other important countries such as the United Kingdom (UK), Japan and emerging powers has to be left to further research extending the empirical basis of this work. In analysing the possible relevance of ideas for governmental positions, I will focus on speeches by heads of governments and politicians heading the responsible ministries (finance, economy and foreign affairs). In these speeches, I will search for evidence that shows whether or not preferences differ concerning ideas on policy contents and political processes relevant in the respective society. In examining the possible influence of interests, I will use speeches and press releases of business associations as well as documents and speeches of the politicians and relevant ministries in order to analyse whether their positions correspond to the interests of business groups. The case studies are also intended to show the conditions for the prevalence of either ideas or interests on national preference formation.

Exemplifying hypotheses via the statements of politicians can provide only plausibility, not proof. A public statement by the government underlining its positions with material interests or ideas does not necessarily provide the real reasoning behind the government's preference. When governments underline their preferences with ideas, then they can, for example, also draw a rhetorical picture to promote hidden material agendas, such as protectionism or market access. However, public statements give evidence for what the government considers acceptable to the voters and therefore legitimate. Thus, I assume that governmental preferences will in principle reflect attitudes grounded on real endogenous patterns of legitimate ideas and interests. In order to secure this link between governmental preferences and societal ideas and interests, the empirical evidence on governmental preferences focuses on quotations of political decision makers of the responsible ministries and of heads of government who—based on the standard assumption of self-interest to remain in office—will position themselves on patterns acceptable and thus legitimate in the eye of voters. The stances of expert bureaucrats are not considered, both because they do not ultimately decide and because they are not accountable to voters—although ministerial bureaucracies might influence the international negotiation process (which is not under scrutiny here).

Domestic ideas and governmental preferences: the reform of the IMF

The IMF was created as part of the Bretton Woods system, which aimed at securing the stability of exchange rates and the international balance of payments. If a member country has problems with its balance of payments, it can ask the IMF for financial assistance, which the latter then provides under the condition that the borrower adjusts its economic policy in order to improve its balance of payments. After the breakdown of the Bretton Woods exchange rate regime in the 1970s, the IMF played a crucial role in managing the debt crisis in Latin America in the 1980s, the financial crises in Asia and other emerging markets such as in Russia and Argentina in 1997–1998. The IMF has been criticized for not preventing these crises and for mishandling their management for example in South Korea and in Argentina (Meltzer 2000; Bird 2003; Blustein 2003). In addition, recently the IMF has faced a declining demand for its loans because countries such as China, Brazil and Argentina built up huge currency reserves in order to protect themselves against financial market turmoil. Furthermore, since the end of the 1990s, the US government has been advocating a reduction of the IMF's programmes and funds as a measure to focus the Fund on its core duty (surveillance of exchange rates) and to prevent it from providing a safety net for financial markets through huge lending in crises situations (which might create a 'moral hazard'), thereby leading it to follow a more market-based approach (Schirm 2004, 11–15; Helleiner and Momani 2007, 2–10; Kenen 2007).

The IMF has also been criticized for being an instrument of the foreign policy of its most influential member state, the US. Indeed, research confirms that the IMF over time did act in favour of the policy goals of the US and its banks (Broz and Hawes 2006). Thus, it is puzzling that the US government has been demanding a downsizing of the IMF's activities and budget in the last decade because this might counteract the strategic interests of the US as well as the material interests of its banking community. According to Broz and Hawes (2006, 374–376) major American international banks heavily lobbied Congress in the 1990s to increase the Fund's spending ability in order to secure IMF bail-outs as an insurance for their loans to developing and newly industrializing countries. Thus, a specific puzzle arises with regard to the US: why does the US government favour a restriction of the Fund's activities (contrary to Germany), given that the IMF fulfils US strategic as well as economic goals? In order to answer this question it is fruitful to go beyond the examination of interests as an explanatory variable as Broz and Hawes did, and to analyse domestic ideas as a formative influence on governmental positions.

In addition to this specific puzzle for the US, the broader puzzle remains with regard to the IMF: why do governments diverge on strategy when they agree on necessity? Since the 1990s, several financial crises increased the necessity for a more efficient management of financial markets by the IMF. This need is acknowledged by governments, but no substantial reform of the IMF has been achieved due to divergent positions among key players, such as Germany and the US. The following examination will show that—regardless of the potential economic benefits of more efficient governance and material considerations—the positions differ because they are shaped by divergent ideas inside the two countries about how to steer the economy. Distributive questions were only affected in a diffuse way and specific interests of domestic groups could not be detected in governmental positions. In this case study, the dominance of ideas shall be evidenced in the most important issue areas of IMF reform with regard to both the IMF's decision-making process and the contents of its policy.

Specification of 'ideas'

First, the independent variable 'ideas' introduced in the previous section shall be specified with some empirical examples for the two countries under scrutiny here. In order to give evidence for path-dependent ideas, public opinion polls will only be used if they refer to fundamental value-based expectations on the role of the government, individuals and the market.

With regard to ideas on the *contents* of policy, the tendency is that Americans emphasize the role of the market and of individual responsibility more than Germans, while Germans tend to emphasize the role of the state and public solidarity more than Americans. Also, in the US, solidarity is seen less as a governmental stronghold (as it is seen in Germany) and more as the realm of private charity. On the role of the state, figures from Heien (2002, 113–114) show that the state is held responsible for the provision of healthcare by 67.8 per cent and for the living standard of the elderly by 73.6 per cent of Americans, but by ninety-two per cent of Germans in both areas. More Germans agree than disagree with the statement that the state is responsible for the reduction of income inequalities (net figure: + 22.5 per cent) while more Americans *disagree* than agree (net figure: − 6.6 per cent). Data from World Values Survey (WVS) (2004, V 142) on the role of private responsibility for the economy show that twenty-six per cent of Americans favour more private ownership of business compared to only fourteen per cent of Germans. The moderate (rather than fundamental) differences expressed in these figures are reflected in the economic systems of the two countries. Both are market economies, but while the US is seen as a liberal economy, Germany is considered as a social market economy.

With regard to ideas on the political *process*, the basic tendency is that Americans accept majoritarian decisions and the-winner-takes-it-all situations more than Germans, who emphasize consensual decision-making and the inclusion of all relevant actors. This difference is also moderate and not fundamental in nature, as both countries are pluralistic democracies and share both ideas—just not to the same degree. Empirical evidence on diverging process ideas with regard to the market as a process driven predominantly by either private actors or the government can also be found in figures from the WVS (2004, V 144, V 157): while thirty per cent of Americans support the statement that competition is a force for good, only sixteen per cent of Germans agree with that statement. The difference in confidence in market forces is also evident in that fifty-four per cent of Americans versus only thirty-six per cent of Germans show 'confidence in major companies' ('a great deal/quite a lot'). These different process ideas are expressed institutionally in form of the 'coordinated' versus 'liberal' character of the two economic systems according to Hall and Soskice (2001). The 'coordinated' patterns in Germany and the 'liberal' ones in the US can be taken as evidence for the institutional anchoring of the ideas of 'solidarity/consensual decision-making' in Germany and 'individual responsibility/competitive decision-making' in the US (see also Pauly and Reich 1997; Scharpf and Schmidt 2000; Seeleib-Kaiser 2001; Schirm 2002b, 222–224). In the following subsections, I will show that these differences in ideas are reflected in the preferences of governments with regard to the ideas of 'public solidarity versus individual responsibility', 'regulation of market versus trust in market', and 'inclusive decision-making versus leadership according to contributions'.

IMF decision-making and process ideas

The IMF is governed by its members, whose power rests on their voting quotas. With seventeen per cent of the votes, the US has the largest quota and a veto power because fundamental decisions have to be approved by eight-five per cent of all votes. Japan and Germany possess the second largest voting quotas. The distribution of voting quotas today does not reflect the rise of emerging markets in the last twenty years and is often criticized because it endangers the legitimacy and efficiency of the Fund. Many developing and newly industrializing countries (NICs) and also some industrialized countries—such as Germany and the US—are underrepresented when comparing their voting quotas and their share in world-GNP. A very modest increase of the quotas of only four emerging markets (Turkey, South Korea, Mexico and China) was agreed upon in 2006; India and Brazil, who were left out, strongly opposed this step. No substantial reform was achieved because of divergent preferences of key players.

Germany and the US differed fundamentally with regard to quota reform. Germany advocated an increase in voting shares of NICs and was willing to give up a share of the voting power of industrialized countries—including its own—in order to change the distribution of power within the decision-making process of the IMF. In contrast, the US wanted to increase the voting shares of some NICs and developing countries without reducing its own voting share. The US' only concession was that it was willing to forgo an increase of its own quota. The reasons for these different positions given by the relevant policymakers clearly reflect the different ideas prevailing in the two societies on how to organize policy processes. While the US stressed leadership, the shareholder character of the IMF and the link between contributions and voting shares, German policymakers emphasized consensual decision-making by underlining the equality of all participating countries regardless of financial contributions:

- US: Secretary of State Colin Powell (2001) stressed the necessity of a 'strong United States leadership in the IMF'.
- US: 'The IMF is a shareholder institution'. (Treasury Secretary John W Snow 2005)
- US: 'We repeat our commitment to forgo the additional quota we would receive in the second stage increase beyond what we need to maintain our pre-Singapore voting share'. (Treasury Secretary Henry M Paulson 2007b)
- Germany: Chancellor Schröder (2002) wrote: 'After all, we need a truly democratic trade and financial regime in the world'.
- Germany: 'Considerations should also be given to the role the quota formula should play in ensuring cohesiveness and equity between the Fund's members. It should support a balanced distribution of quotas amongst all Fund members'. (Finance Minister Peer Steinbrück 2007b)
- Germany: 'Germany supports efforts to strengthen voice and representation of developing countries'. (Finance Minister Hans Eichel 2004)

IMF policy and content ideas

The IMF was originally created in order to oversee exchange rates but grew into an organization that helped countries with balance of payments problems through short-term stand-by lending. The conditions attached to this lending aimed at improving the balance of payments situation of the borrower. The debate on a reform of the Fund's policy essentially centres on whether it should focus on surveillance or be more involved in lending and regulation. The basic difference between German and US positions refers to whether market forces should be trusted or embedded by the IMF and to whether the IMF should have a stronger or weaker role in governing the market and in lending. Two quotations give evidence for the general difference in policy direction 'trust in market forces' versus 'regulation of markets':

- US: For the IMF, we will seek to refocus it on its core mission: international financial stability. This means strengthening the IMF's ability to monitor the financial system to prevent crises before they happen. If crises occur, the IMF's response must reinforce each country's responsibility for its own economic choices. A refocused IMF will strengthen market institutions and market discipline over financial decisions, helping to promote a stable and prosperous global economy. (The White House 2006, 30)
- Germany: More than ever we need cooperation with other states and international institutions in order to promote international financial markets in those regards in which they offer opportunities for growth, wealth and employment, but also in order to prevent incalculable risks and economically damaging erroneous developments through effective surveillance and regulation [of financial markets]'. (Finance Minister Peer Steinbrück 2007a)

More specifically, the two countries differed with regard to whether the IMF should (1) only be in charge of the surveillance of exchange rates or also of financial markets; (2) stick to surveillance or engage in lending; and (3) consider poverty reduction as part of its policy.

(1) Surveillance: exchange rates/financial sector

The contentious issue here is whether the IMF should focus on securing the stability of exchange rates and balance of payments through surveillance of exchange rates favoured by the US or whether it should expand its surveillance to the financial sector in general. The latter is supported by Germany and would increase the Fund's influence not only on the international level, but also allow it to strongly affect domestic regulation of financial markets:

- US: 'Exercising firm surveillance over members' exchange rate policies is the core function of the institution.... This should enable firmer surveillance in areas where market forces are not the prevailing paradigm'. (Treasury Secretary Henry M Paulson 2007)
- Germany: 'It is particularly important that the Fund should bring its coverage of financial sector and capital market developments, including at the global level, to the same level as its other core areas of expertise in surveillance'. (Finance Minister Peer Steinbrück 2007b)

(2) Lending: limitation of lending/expansion of lending

The US government opposes lending by the IMF because it fears moral hazard and trusts market forces. Thus, the US favours a restriction of IMF lending and a focus on securing stability through surveillance. In contrast, Germany considers lending a core task of the IMF with regard to a recipient country's domestic economic policy:

- US: 'Limiting official resources is a key tool for increasing discipline over lending decisions'. (Treasury Secretary Paul H O'Neill 2002)

- US: 'Rather than responding to global developments by expanding its mandate and making its efforts more diffuse, we believe the IMF needs to adapt and refine its core mission of promoting international financial stability and balance of payments adjustment'. (Treasury Secretary John W Snow 2005)
- Germany: 'In case of balance of payments difficulties the IMF can grant credits and loans to its member countries in order to support their economic adjustment and reform policies. In this regard, the IMF will focus increasingly on considering the social effects of its measures and on poverty reduction'. (Bundesregierung and Deutscher Bundestag 2004, 19)

(3) Poverty Reduction: not IMF task/IMF task

With regard to poverty reduction, the US opposes international solidarity through financial aid by the IMF, while Germany wants the IMF to continue and to expand its poverty reduction activities:

- US: 'The IMF is not a development agency, and we strongly concur ... that the IMF's financing role in low-income countries should focus on actual balance of payments needs as it does in emerging market members', (Treasury Secretary Henry M Paulson 2007a)
- Germany: 'PRGF [Poverty Reduction and Growth Facility] arrangements remain the core instrument of the Fund to contribute to poverty alleviation ... Germany supports a financially augmented self-sustained PRGF'. (Finance Minister Hans Eichel 2004)

Result

The US government emphasizes that those countries that fund the IMF should have more influence in decision-making than those countries that receive financial support from the IMF. With regard to policy, the US underlines individual responsibility as well as trust in market forces and the goal of reducing IMF programmes to surveillance and emergency aid. The German position shows less trust in market forces than the US position, wants international solidarity through an expansion of IMF programmes on financial markets and poverty reduction, and favours a strengthening of the developing countries and NICs in the decision-making of the Fund. Ideas as an independent variable allow a plausible interpretation of the diverging positions of the two governments. The preferences diverge along different content and process ideas with regard to 'public solidarity/individual responsibility', 'regulation of market/trust in market', and 'inclusive decision-making/leadership according to contributions'. The differences between the governmental preferences could not be overcome by consensus building. While this paper analysed the domestic sources of governmental preference formation in Germany and the US, the international negotiations on the IMF have certainly also been influenced by other member states and the institutional dynamics of the IMF.

Domestic interests and governmental preferences: the Basel II Accord

Unlike the IMF, which aims at governmental policy-making and only indirectly affects private companies, Basel II directly governs private business by setting standards and therefore by influencing competitiveness and costs of firms. The multilateral negotiations between governments on the Basel II Accord in the Basel Committee on Banking Supervision intended to reform the standards which banks must follow when lending: 'The aim of Basel II is to align the amount of capital that banks set aside to absorb unexpected losses with the amount of risk that they are taking' (Economist 2008).

Claessens, Underhill and Zhang (2008, 316–317) argued that Basel I suffered from the weakness 'that the capital reserves assigned to loans did not distinguish between real default risks of different sorts of debtors', while Basel II intends 'to measure risk exposure better, to emphasize better internal controls and risk management, and to increase the role of market discipline'. The negotiations were conducted on the German side by the Bundesbank and the Federal Surveillance Office for Banks (BaFin) and on the US side by the Office of the Comptroller of the Currency (OCC) and the Federal Reserve System. Thus, unlike the IMF case, the German Finance Ministry and the US Department of the Treasury did not participate directly in the negotiations. Instead, they oversaw and controlled the agencies mentioned above. A first look at the governmental positions shows that neither government conforms to ideas in their statements. Instead, the positions reflect the material interests, the costs and benefits of the economic sectors affected, especially those of the banking community. Therefore, this case study seems well suited to give evidence for the influence of interests articulated by lobbying groups. The lobbying activities of individual banks (such as Mellon and State Street) as well as banking and industry associations have been widely reported in the media (see Wanner 2001 and 2003; Loch 2002; Chaffin and Pretzlik 2003; Economist 2003; Ehrlich and Lebert 2003; Krosta, Pretzlik and Silverman 2003; Silverman 2003). The following quotations show both the demands of lobbying groups and the positions of governments vis-à-vis the evolving Basel II proposals in the last decade. Thus, the four issue areas below are examples of the influence of domestic interests on governmental preferences and not a full account of the complexity of the development of private and governmental positions and negotiations (for the latter see Claessens, Underhill and Zhang 2008, 318–327; Tarullo 2008, 87–137).[3] In order to reach a high representation of the variable 'interests', only documents from associations representing the involved sectors such as the American Bankers Association, the Bundesverband Deutscher Banken and the Bundesverband der Deutschen Industrie and no positions of individual companies were considered.

(1) Affected banks

US lobby groups pressured the government to apply the new Basel II rules only to large, internationally active banks. The US government acceded to these demands. The question of which banks must implement Basel II was not a lobby issue

[3] Transnational lobby groups such as the Institute of International Finance in Washington DC are not considered here, because they essentially lobbied the Basel Committee directly, while national banking and industry associations lobbied their respective national governments.

in Germany because, in the EU, different standards were set for small and large banks, while all banks had to implement Basel II:

- US Interest Group: 'We support the concept that the New Accord should only be applied to the largest internationally active banks and others that elect to adopt its requirements. The complex standard is not appropriate to most small community banks'. (American Bankers Association 2003, 2)
- US Government: 'Maintaining an appropriate competitive balance in the U.S. between our large, internationally active banks, on the one hand, and the thousands of smaller banks and thrift institutions, on the other hand, is the crucial consideration'. (John Hawke, Comptroller of the Currency 2003, 3)
- US Government: 'As noted, we anticipate that only one or two dozen institutions would move to the US version of Basel II in the near term, meaning that the vast majority of US institutions would continue to operate under Basel I-based rules'. (Susan Schmidt Blies, Governor of the Board of Governors of the Federal Reserve System 2006)

(2) Form of rating

US banks traditionally use internal rating mechanisms as well as external rating agencies such as Moody's and Standard & Poor in order to assess their risk exposure and the creditworthiness of borrowers. In contrast, German banks traditionally focus on internal rating mechanisms for borrowers with whom they have a long-term involvement as 'Hausbank' of a company. German banks found that the cost of adapting to the improved risk measurement and especially the external rating planned in Basel II was heavier for them than for US banks (Wanner 2003; Kerwer 2004, 217). Thus, German banks lobbied to maintain some traditional internal risk assessment methods and to ease the pressure of adaptation to external rating. The government acceded to these demands, and Chancellor Schröder and an all-party resolution of the Bundestag supported the interests of German banks and companies (the latter fearing increased borrowing costs through external rating) vis-à-vis the Basel II proposals (Heusinger 2001; Deutscher Bundestag 2001):[4]

- German Interest Group: 'We explicitly welcome the introduction of an Internal Assessment Approach (IAA) announced in the working document. … the possibility for applying the IAA should be extended considerably … . It would contradict the systematic of Basel II to force the banks to implement an IAA according to the procedures of a recognized external rating agency, when this bank practices an internal risk assessment system'. (Zentraler Kreditausschuss der Deutschen Banken 2004)
- German Government: 'The banks can estimate all four risk parameters themselves. The resulting risk assessment system internal to the banks has

[4] In the US, large internationally active banks especially supported the 'Advanced Internal Ratings Based (IRB)' approach included in the course of the Basel II process as well as the strengthening of external rating and the 'Foundation' version of the IRB (Claessens, Underhill and Zhang 2008, 317).

to be approved by the supervising agency BaFin'. (Bundesministerium der Finanzen (BMF) 2006, 59)

(3) Implementation schedule

US banks heavily lobbied policymakers to delay the implementation of Basel II in the US and to make final implementation dependent on analyses and on first experiences of its effects. The success of this lobbying by US interest groups triggered opposition from German lobby groups that feared a distortion of international competition since German and EU banks would have to implement Basel II before US banks. German lobby groups were also successful in shaping their government's position:

- US Interest Group: 'ICBA remains concerned about the competitive disparities between Basel I and Basel II and recommends that the implementation of Basel II ... be delayed until the U.S. regulators have completed their analysis ... and have come to a consensus concerning its competitive impact'. (Independent Community Bankers of America (ICBA) 2005)
- US Government: 'The banking regulators announced a delay in the implementation of the phase-in period for Basel II, which will not begin until 2008, a year after European banks will begin implementing Basel II'. (Under Secretary of the Treasury Randal K Quarles 2006)
- German Interest Group: 'Voices are heard from the USA that the American side might want to implement Basel II later. However, no time should be lost in accomplishing the project also in its planned international scale'. (Executive Director of the Bundesverband der Deutschen Banken [Federal Association of German banks] Manfred Weber 2005)
- German Government: 'I observe with great concern that Basel II is implemented within the European Union, but at the same time one is starting to hesitate in the last second on the other side of the Atlantic. That was not the intention of Basel II. Therefore, we have to talk about this with the American partners once more'. (Angela Merkel 2006)

(4) Small and medium sized enterprises (SMEs)

Special treatment for SMEs was an important issue for German lobby groups because SMEs form a large group of the German Industry Association's (BDI) members and are considered to be the backbone of the German economy. Heavy lobbying made the government negotiate special rating and borrowing conditions for SMEs in Basel II (see 'Form of Rating' above). SME demands were not a major issue for US lobby groups on Basel II:

- German Interest Group: 'The proposed directive put forward by the EU Commission for the implementation of Basel II needs to be redesigned to cater better to the need of the SMEs. The objective must be that the markedly lower risk ballast for the small and medium sized enterprises ... are given full consideration'. (Bundesverband der Deutschen Industrie 2004)
- German Government: 'The Federal Government has taken care that EU directives are implemented in a favourable way for medium-size firms. In this

regard, we accomplished an agreement on medium-size-firms in the international negotiations on Basel II'. (Bundesregierung 2006)

Result

The divergent preferences of the US and German governments clearly reflect the different interests of those sectors directly affected by the new governance initiative. Banking and industry associations lobbied and apparently induced the respective governments to follow their positions. In the end, the Basel II negotiations reached a compromise on which both sides could agree: external rating was complemented with possibilities of internal rating and the additional costs for long-term lending (traditionally stronger for German SMEs than in the US) were moderated to a level acceptable to the German side. The delay in implementation of Basel II in the US and the kind of banks affected by Basel II in the US are still under discussion. In sum, core distributional conflicts between Germany and the US were gradually solved by mutually acceptable partition of the costs of adjustment to new governance rules. While this paper focussed on the domestic influences on governmental preference formation in Germany and the US, the international negotiations on Basel II have, of course, also been influenced by other factors (such as institutional settings), other states (such as the UK), and private actors (such as the Institute of International Finance). Even though some issues are still contested, negotiators have agreed on most elements of Basel II.

Conclusion

Why do governmental preferences towards global governance diverge despite a shared perception of the need for a better management of financial markets? The explanatory approach outlined in this paper and the empirical exemplification of the hypotheses showed that the preferences of governments were decisively shaped by domestic ideas or interests, which led to cross-country divergence. The plausibility of this result is based on the incorporation of interests as well as ideas into the analysis. An exclusive consideration of one of these two variables would have allowed only for a partial explanation of divergences.

Why do governments agree on a reform of global governance in some cases but not in others? More specifically, which domestic conditions influence the ability of governments to compromise internationally? The case studies supported the hypothesis that new governance succeeds more easily when differing interests come to bear than when diverging ideas meet. Differences in material interests were open to compromise through a partition of the costs and benefits of new governance. On the other hand, divergence of ideas with regard to the core tasks of politics towards markets (contents ideas) and to political decision-making (process ideas) was not amenable to consensus-building. Even though the factors identified here are consistent with the outcomes of the negotiations on Basel II and the IMF and could plausibly have influenced them, no causality is implied here, since a comprehensive investigation of the negotiations would have to include additional actors and factors.

When do ideas prevail over interests and when interests over ideas? The results of the case studies support the argument that interests prevail when they are affected directly and distributive questions dominate the debate, while ideas prevail when interests are affected diffusely and fundamental questions on the role of politics in governing the economy dominate the debate. Thus, two conditions can be specified with regard to the prevalence of either ideas or interests.

First, an important condition seems to be the *intensity with which specific interests are affected* and with which they are articulated vis-à-vis the government by lobby groups. Domestic interests formed the dominant influence on governmental positions in the case in which interest groups were affected directly through changes in costs by the planned governance rules and in which they were lobbying the government. On the other hand, ideas prevailed in influencing governmental preferences in the case in which no interest group seemed affected directly by costs and in which fundamental questions of the role of politics in governing the economy were debated. Thus, neither the German nor the US position towards the Basel II negotiations were dominated by ideas but both strongly reflected the interests of affected and active lobby groups. On the other hand, both governments' positions on the reform of the IMF clearly mirrored endogenous content and process ideas while lobby group interests did not figure in governmental statements. Apparently, the global public 'bad' of a suboptimal management of financial crises by the IMF did not privilege or under-privilege specific interest groups to the degree necessary to mobilize intensive lobbying on a new strategy for the IMF. Thus, with regard to intensity, interests prevailed over ideas when interests were strongly affected directly, while ideas prevailed when interests were affected only in a diffuse way.

Second, another condition decisive to the question on the prevalence of either ideas or interests is the *policy issue at stake*: does the global governance initiative concern fundamental questions on the role of politics in governing the economy, or does it concern the distribution of costs and benefits in specific areas? Evidence from the case studies supports the claim that ideas bear the dominant influence on governmental preferences when fundamental political questions are at stake, as happened with regard to a reform of the IMF. Here, the issues under scrutiny revolved around the role of the state and the market in governing the economy as well as the form of participation in decision-making and thus about the contents as well as the process of policy. These issues apparently strengthened the influence of ideas on the preferences of the two governments. The other case study supports this explanation, because the issues at stake at the Basel II negotiations referred to specific material and distributive questions on banking standards, triggering strong activities by lobby groups, which sought to promote their interests vis-à-vis the government. Thus, interests prevailed over ideas when distributive questions dominated, while ideas prevailed over interests when fundamental questions about the role of politics in governing the economy dominated the governance debate.

The separation of ideas and interests in this paper was undertaken for the purpose of analytical clarity. Human action and governmental preferences will often include elements of both. However, which of these two variables prevails in a given area does make a difference—not only to analysis but also to governmental preference formation and to the future of global governance. All conclusions of this paper must remain preliminary in nature due to the small number of cases and to the short empirical exemplification of the hypotheses. Because of the focus on the role of domestic interests and ideas in governmental preference formation and on the domestic conditions for the ability of governments to compromise internationally, an overall explanation of the international negotiations is left to further research, which would have to include additional explanatory factors and actors other than the two countries examined here. In principle, the hypotheses about the role of ideas and interests in national preference formation can be applied to other policy areas, economic governance (such as trade, investment and development) plausibly being more suitable then security issues. Thus, the extension of the analytical approach to additional actors and policy issues seems to constitute an interesting field for future research. In sum, a core result of this paper is that a comprehensive explanation of the preferences of governments and of their ability to compromise on global financial governance only becomes possible when the analysis goes beyond international institutions and regimes and includes domestic ideas and interests as major driving forces.

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