Getting One's Ducks in a Row

Empowering Expert Knowledge to Manage Financial Liberalization in Asia and Latin America

SCUOLA
NORMALE
SUPERIORE

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We are healthy only to the extent that our ideas are humane

Kurt Vonnegut

[I]f reality does not determine the calculated value, then at least the calculated value must determine reality

Erwin Schrödinger

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Abbreviations

AFP Private pension funds (Administrado de Fondos de Pensiones)

ARS Argentine peso

ASEAN Association of Southeast Asian Nations

BCC Chilean central bank (Banco Central de Chile)

BCBS Basel Committee on Banking Supervision

BICE Bank for Investment and Foreign Trade

BIS Bank for International Settlements

CEDIN Certificado de Dep´osito para Inversi´on

CEFP Council on Economic and Fiscal Policy

CEMA Centro de Estudios Macroeconómicos de Argentina

CEPAL Economic Commission for Latin America and the Caribbean

CEO chief executive officer

CLACSO Latin American Council of Social Sciences

CLP Chilean peso

CMF Financial Market Commission

CNV National Securities Commission

CONICET National Scientific and Technical Research Council

DIC De- posit Insurance Corporation

DTI debt-to-income

DSGE dynamic stochastic general equilibrium modeling

EMEAP Executives' Meeting of Asia-Pacific Central Banks

ESSF Economic and Social Stabilization Fund

ETF exchange-traded fund

FGS Sustainability Guarantee Fund

FSA Financial Services Agency

FSB Financial Stability Board

FSC Financial Services Commission

FSS Financial Supervisory Service

G20 Forum of 20 large economies for international economic cooperation

GDP gross domestic product

IDES Institute of Economic and Social Development

IEERAL Instituto de Estudios Económicos sobre la Realidad Argentina y Latinoamericana

IMF International Monetary Fund

FIDE Development Research Foundation

FILP Fiscal Investment and Loan Program

J-REITS Japanese real estate investment trust

JPY Japanese yen

KAMCO Korea Asset Management Corporation

KDI Korea Development Institute

KDIC Korea Deposit Insurance Corporation

KOFEX Korea Futures Exchange

KRW South Korean won

LEBAC Argentina central bank securities (Letras del Banco Central)

LELIQ short-term Argentina central bank securities (Letras de Liquidez)

LTV loan-to-value

NDF non-deliverable forwards

NOBAC Argentine Central Bank Notes (Notas del Banco Central)

OECD Organisation for Economic Co-operation and Development

PFPB Bicentennial Productive Financing Program

PhD Doctor of Philosophy

PRF Pension Reserve Fund

PRO Republican Proposal (Propuesta Republicana)

SBIF Superintendency of Banks and Financial Institutions

SEACEN South East Asian Central Banks

SEDESA Seguro de Depósitos S.A

SIPA Argentine Integrated Pension System

SMEs small and mid-size enterprises

SP Superintendence of Pensions

SVS Superintendency of Securities and Insurance

UCLA University of California

UF Unidad de Fomento

URR unremunerated reserve requirements

U.S. United States

USD United States dollar

UVA Unidad de Valor Adquisitivo

UVI Unidad de Vivienda

YPF Yacimientos Petrolíferos Fiscales

Chapter 1

Introduction

To what extent can governments exert domestic agency in policymaking in a globalized and globalizing world? This question has been a prominent researched topic in the field of international political economy and policy change. Mechanisms through which convergence pressure is exerted have been extensively researched, leaving observed divergence somewhat understudied - examples are different policymaking in monetary policy, fiscal policy, financial regulation but also governance of pandemics and migration. By specifying one mechanism through which policy divergence occurs, this study aims to complement theories that cannot fully explain observed policymaking.

This thesis presents and tests a factor that has been largely absent in the divergence literature and that can be used by states to enhance domestic agency in managing globalization pressure: expert knowledge. This lack of attention is insofar surprising insofar as expert knowledge has been identified as a mechanism for generating policy convergence via transnational epistemic communities (Johnson, 2016) and international organizations which translate dominant Western ideas to replace domestic ones (Pauly, 1998; Preet, 2009; Wade, 2002; Stiglitz, 2004; Babb, 2009). It has thus been implicitly assumed that this mechanism works in the direction of convergence and, at best, is domestically adjusted (see Ban (2016)). Nevertheless, expert knowledge was found to explain policy divergence, although merely in form of a variable that is structurally predetermined by nationally specific knowledge regimes (Campbell and Pedersen, 2014). Expert knowledge as a source of agency for inducing policy divergence has largely been absent in the existing literature.

The ~~modest~~ contribution of this thesis is to test whether this mechanisms

works also the other way around by analyzing the extent to which expert knowledge is used by states for enhancing domestic agency to circumvent convergence pressures. It uses the case of financial liberalization as one form through which these pressures are transmitted. As a further contribution, it analyzes under which conditions specific types of expert knowledge become consequential. It is investigated how expert knowledge is empowered in certain moments in time by governments to induce policy change to manage a liberalized financial system. By identifying *empowerment of expert knowledge* as source of agency, the thesis adds to contributions that demonstrate how states have capacity to shape policymaking to counter globalization pressures and maintain domestic control over policymaking (Weiss, 1998, 2004; Thurbon, 2016). Based on the established argument that state policies matter in the management of financial liberalization, this dissertation aims to enhance it by identifying expert knowledge as a resource to develop policies and thus produce agency.

The theoretical background, from which expectations of causal relations are derived, build on the literature of policy ideas. This thesis adds to this literature by demonstrating how policy ideas shape policymaking, whether in a functional or constructivist manner. Depending on the adopted types of expert knowledge, diverging policymaking is expected to occur. What this literature somewhat lacks is that, by adopting a bottom-up approach to trace the translation of ideas into policies (e.g. Thiemann (2018)), mechanisms of political power that work top-down are left aside. To account for this shortcoming and analyze conditions under which expert knowledge becomes consequential, its empowerment by governments through the appointment of experts to key policymaking positions is investigated. It is expected that, fundamentally, it is in the government's hand to empower expert knowledge that suits its preference.

The analytical strategy in this study is to identify and analyze, firstly, the empowerment of expert knowledge by governments and, secondly, the observed policy change. The objective is to test whether a causal impact of the former on the latter variable can be observed. It is expected that differences in expert knowledge, once empowered by governments through the appointment of experts to key policymaking positions, result in diverging policies across the observed cases.

Central banks Although multiple political institutions share responsibility to manage a liberalized financial system, central banks are the primary analytical focus point for identifying and analyzing the political empowerment of expert knowledge and its translation into policies. Two main reasons speak in favor of focussing on central banks. Firstly, they are responsible for a range of policies that affect the management of financial liberalization, encompassing monetary policy, financial regulation, foreign exchange policy, regulation of public financial institutions, and the development of financial markets. Thus the use on central banks as main indicator for the analysis of selection of expert knowledge by governments should serve well to fulfill the research objective.

Secondly, central banks serve as prime example for the delegation of policymaking from politicians to experts based on the assumption that central bankers as neutral experts will adopt optimal policies. Political influence needs to be curtailed to a minimum, according to this perspective, as this would result in policies that are considered to be suboptimal (such as inflation and financial crises). They thus serve as a useful case for studying the impact of expert knowledge on policymaking given their comparatively direct control over policymaking. Moreover, by studying the empowerment of new expert knowledge, this study assesses to what extent governments influence central banks in spite that they are formally autonomous from political influence.

Time frame and the four cases The unraveling of the Bretton Woods system in 1971 serves as the motivation for selecting this year as the starting point of the analysis. This system was based on the premise that states should control international trade and financial flows to promote domestic development. Following the end of this system when the United States discontinued the convertibility of the US dollar into gold in August 1971, financial liberalization advanced rapidly and the primacy of nation states to determine financial flows was discontinued (see Helleiner (1996)). Thus 1971 can be considered as the the starting point of globalization via financial liberalization.[1]

Among Western advanced economies, this convergence theory explains rather well the adjustment of policymaking over time (e.g. McNamara (1999)).

[1]This was not the first time of financial liberalization cum globalization. Already in the 19th/early 20th century global trade in goods and finance occurred (Bordo et al., 2003).

However, this literature cannot explain divergence in policymaking that can be observed in non-Western countries. This thesis deploys a nested most-similar in most-different comparative design for accounting for the observed differences in the value of the dependent variable (policy change) and test the expected causal effect of the independent variable (political empowerment of expert knowledge). It is demonstrated how policy divergence can be observed in most-similar cases (Argentina and Chile on one hand, Japan and South Korea on the other) following differences in empowered expert knowledge. The empowerment of related exert knowledge in most-different cases (Argentina and Japan on one hand, Chile and South Korea on the other) resulted in the adoption of similar policies.

All of the four cases (Argentina, Chile, Japan, South Korea) pursued developmentalist strategies in the Bretton Woods era that were based on similar types of expert knowledge (import-substituting industrialization in the former two, export-led industrialization in the former two). The common paths diverged after the end of the Bretton Woods system. Following initial financial liberalization, diverging policy paths can be observed: Argentina and Japan adopted policies to intensify financial liberalization, entailing further opening of the financial system to global liquidity; curtailing of financial regulations; adoption of flexible exchange rate regimes; and privatization of public financial institutions. In contrast, Chile and South Korea introduced policies that aimed at regulating international financial flows. These financial stability-oriented policies incorporated monetary policy that stands ready to inject liquidity in domestic and foreign currency while countercyclically setting the policy rate; financial regulation that reduces risks attached to international financial flows and improves transparency for reducing credit risk; flexible exchange rate management to counter destabilizing movements of the currency, particularly appreciation pressure; public financial institutions to improve foreign exchange management, develop domestic capital markets, and inject liquidity in times of crisis; and domestic capital markets that enhance independence from global finance and help to liquidate bad assets that clog balance sheets of financial and non-financial companies.

By conducting this comparative study, this thesis makes a theoretical and an empirical contribution. Firstly, it complements existing explanations of divergence in country's management of financial liberalization by advancing the concept of *political empowerment of expert knowledge*. Secondly, the comparative study of four non-Western countries brought about the identification of variety of the independent and dependent variables. Since most

studies focus on Western cases where this variety is not observable, the generalizability of causal arguments is enhanced.

Methodology and data The methodological task is to identify and analyze the relation between policies (dependent variable) and the political empowerment of expert knowledge (independent variable). For the identification of dependent variable (policies), legal documentations (laws, regulations, central bank documents) and descriptive statistics from central banks and regulatory agencies are used. The independent variable is disaggregated into political empowerment and expert knowledge. The operationalization of the former is straight forward, as it implies the need to identify the appointment of experts to key policymaking positions. Concerning the identification of expert knowledge, it is presumed that it finds its expression in official central bank documents. Central bank speeches are used as prime indicator, complemented by annual reports, financial stability reports, minutes of policy setting committees, and central bank reports to the parliament. To increase the validity of the data, 27 interviews with (former) policymakers and academic experts were conducted. As a further means of triangulation, central bank speeches that were offered only in foreign languages were made accessible for analysis by the their systematic translation into English.

Findings The empirical study found domestic agency on two dimensions: Firstly, *political agency* was found with governments that can induce policy change by selecting from various types of expert knowledge. The analytical chapters demonstrate how diverse motivations of governments to empower specific expert knowledge delineate the conditions under which ideas become consequential. In most cases, specific expert knowledge was empowered given its *convenience*, not due to ideological or purely technocratic considerations. Interestingly, experience-based knowledge rather than academic knowledge faired better in developing policies that helped countries to exert agency by the adoption and adjustment of policies.

As a prerequisite to establish this mechanism of political agency, governments in Japan and South Korea induced institutional reforms in the late 1990s to strengthen their control over policymaking vis-à-vis powerful bureaucracies. Only after institutional reforms following financial crises in the late 1990s, they could reinforce their control over policy change by constituting their power over the appointment of experts to key policymaking posi-

tions. Expert commissions played a crucial role in this process of change, as they allowed governments to develop blueprints while sidelining the bureaucracy and interest groups. This was different in Argentina and Chile which are both presidential democracies with a comparatively weak bureaucracy *red*but considerably strong interest groups. In both countries, the president, although weaker in Argentina due to its federal structure, could empower expert knowledge comparatively well without having to account for the bureaucracy and interest groups. Research institutions were a key institution used by Argentine and Chilean politicians to produce expert knowledge that was translated into policies. An important insight of the analysis is thus that governments strategically empower expert knowledge to outplay institutions and interests to advance their preferences. Once empowered, experts in policymaking positions can exert agency.

Empowered expert knowledge was in most instances not structurally predetermined as suggested by the literatures on epistemic communities and knowledge regimes. Instead, it was found that learning from crises experiences, the appointment of *outsiders* and the establishment of research institutions served as resources to produce new expert knowledge that allowed the government to select alternative policy paths. Secondly, empowered experts deployed *expert agency* as their development and adjustment of policies cannot be completely anticipated by the government. This is due to the technical complexity inherent to the management of financial liberalization.

Implications What are the implications of the empirical findings? They strengthen, firstly, the perspective that also small countries can offset convergence processes of globalization that are led by powerful Western countries. Secondly, the constant adoption and adjustment of policies to regulate the domestic financial system is important for safeguarding financial stability. Thirdly, they suggest that expert knowledge can serve as one resource for policymaking through which agency can be exerted by governments. Thus targeted investments in the production and diversification of expert knowledge may improve capacity of states to exert agency to counter globalization pressures. Instead of relying on foreign knowledge production and adopting universal expert knowledge, public investments in education and research can offer a way to improve domestic capacity to develop policies that are tailored to country-specific circumstances. In this case, policies can help to reduce negative effects of globalization (such as heightened risk of finan-

cial crisis) and to achieve national objectives. Accountability and evaluation mechanisms may further enhance the quality of policymaking.

Structure of the dissertation Subsequent to this introductory chapter, the literature on policy change is reviewed (Chapter 2). This encompasses the identification of causal mechanisms of both convergence and divergence theories. From this basis, the theoretical model is developed. Furthermore, the case selection is presented, which follows a nested most-similar in most-different comparative design. Chapter 3 introduces the adopted methodology and presents the methods as well as the database.

The analytical chapters follow the comparative design structure: Chile (Chapter 4), Argentina (Chapter 5), South Korea (Chapter 6) and Japan (Chapter 7). The chapters consist of a short introduction into the case, a brief historical overview of the pre-liberalization period (Bretton Woods era), the subsequent initial financial liberalization and financial crises in the 1980s and 1990s. Next, the analytical sections of each chapter identify the selection and type of expert knowledge, and links it with the adopted policies. The concluding chapter 8 discusses key findings, the value added to the literature, and derives political implications.

Chapter 2

Literature review, theoretical model, case selection

What explains the development and adoption of policies deployed by governments to manage financial liberalization?[1] Contributing to the strand of literature that emphasizes the role of state agency, this dissertation presents and tests *political empowerment of expert knowledge* as a mechanism that governments can use to introduce policies that enhance state capacity to counter effects of globalization.

After reviewing the policy convergence literature and identifying its limitations for explaining the observed divergence of policymaking across countries, this chapter discusses the divergence literature. Although this strand has identified a number of mechanisms that can result in policy divergence, these remain insufficient to fully explain the empirical observations for policy change in the four cases. This dissertation aims to enhance existing explanations of policy divergence by advancing the argument that political empowerment of expert knowledge serves as a mechanism for making ideas consequential. Given that there is a variety of expert knowledge available that governments can draw on to inform policymaking, its selection can serve as a source of domestic agency. The dependent variable *policy change* varies in terms of substance of adopted policies. The independent variable *political empowerment of expert knowledge* varies with regard to the political strategy and process of appointing experts to key policymaking positions and the

[1] Financial liberalization is understood as delegating the task of allocating financial resources to private market actors, particularly by opening the financial system to international financial flows.

content of expert knowledge.

Following the literature review (2.1) , the independent (2.2) and dependent (2.3) variables, and the case selection (2.4) are presented.

2.1 Explaining policy change in times of globalization

Theoretical approaches tackling the question of policy change in times of globalization are broadly separated into two main strands of literature. The first presents explanations for policy convergence across countries, the other one emphasizes mechanisms that result in diverging policy outcomes.

2.1.1 Convergence literature

The convergence literature argues that globalization induces an inescapable convergence pressure on domestic policy outcomes. Contributions analyze how political preferences of dominant states, private interests from the financial and non-financial corporate sector, technological innovations, and the rise of neoliberal ideas have promoted a trend of policy convergence directed towards the liberalization of financial systems across the globe (see Dobbin et al. (2007), Beth A. Simmons and Garrett (2010), Holzinger and Knill (2005), and Henisz et al. (2005) for overviews of convergence mechanisms). An extreme position is adopted by the *race-to-the-bottom* strand: It argues that global competition among states constrains agency and pressures state to pursue policies that favor profit interests of the corporate sector. Examples for this position are Abbas and Klemm (2013), Clausing (2007), and Devereux et al. (2002) who show how states reduced tax rates to induce increases of private investments. Evidence from Basinger and Hallerberg (2004) strengthens this argument while they point out that the degree of convergence is affected by political and ideological resistance.

Neo-institutionalists identified multiple mechanisms through which international competition between states promotes policy convergence. Scholars from this strand argue that isomorphic processes result in convergence across countries, as this enhances legitimacy and helps to reduce uncertainty against the background of increased professionalization (DiMaggio and Powell, 1983). Empirical studies have supported this theory, including by contributions that

show how regulatory and ideational competition between states induces policy convergence (Tews et al., 2003; Pirie, 2005b,a; Yeung, 2013). Some contributions even imply a natural, universal tendency to neoliberal Western policies due to their superiority to non-Western policies. An example for this position is Katz (2002, 22) who uses the case of Japan to argue that for overcoming economic problems, it is an "indispensable prerequisite" to replace security-focussed policies with those accommodating Western criteria of efficiency.

A popular case studied to illustrate the relevance of neo-institutionalist type of policy convergence is the evolution of central banking. Polillo and Guillen (2005) present an overview of economic, political, and cultural mechanisms which have led to convergence of central banking across the world. The analysis of Maxfield (1997) lends further support to this view by showing how the adoption of central bank independence by non-Western states have served as a signaling device to attract international financial inflows.

Another strand of the literature focuses on how interests of public and private actors explains policy convergence. Helleiner (1996) shows how political and corporate interests in combination with the rise of neoliberal ideas located in dominant states (particularly the United States) led less powerful states to adopt policies to promote financial liberalization after the fall of the Bretton Woods system in the early 1970s. He bases his analysis partly on Strange (1988) who developed the concept of structural power to show how states can accumulate power resources (security, production, finance, knowledge) to exert adjustment pressure on other countries. An example for a specific mechanism that works in the direction of policy convergence is the liberalization of capital markets: Large global investors, located primarily in the United States and Western Europe, have increasing leverage over policy outcomes as they can threaten to pull out their capital when a government introduces policies they perceive as harming their future profits (Rommerskirchen, 2015, 2019; Campello, 2015).

This leverage of global investors over domestic policy outcomes is amplified for countries that are less economically developed. Dominant countries like the United States can induce pressure on less-powerful countries by exploiting their structural dependence (Cohen, 2018; Kirshner, 1997). As the global financial system is based on few reserve currencies that are exclusively issued by dominant countries, limited access to those currencies for other countries puts them into a situation of dependency (de Paula et al., 2017;

Mehrling, 2013).[2] This becomes particularly evident during financial crises in emerging and developing economies, in which foreign debt (especially US dollar debt) cannot be paid back when access to foreign currency is blocked, for example when global investors panic. As these domestic currencies tend to lose value in times of crises, the foreign debt burden increases even further. Facing this situation, these countries are often forced to resort to international organizations like the International Monetary Fund (IMF) for help to overcome liquidity problems, which in turn requires the recipient countries to induce policy adjustments.

These contributions thus point to the role of international institutions as instruments of powerful countries to generate pressure and stabilize their dominant position. This mechanism is the subject to various studies. Drezner (2007) shows how dominant states use international institutions to control the regulation of the financial system. Other scholars emphasize the function of international organizations as platforms through which policymakers form close network ties that promote diffusion of policies promoted by dominant countries (Bach and Newman, 2010; Slaughter, 1997; Finnemore and Sikkink, 1998; Babb, 2013; Nelson, 2014).

These studies complement contributions which focus on the role of transnational epistemic communities in the diffusion of expert knowledge that shapes policymaking beyond national boarders. Thus beyond institutions and interests, ideas are identified as an additional factor leading to convergence. International organizations have not only served for promoting and translating neoliberal ideas across the globe but also for establishing ideational convergence by establishing and promoting transnational policy networks, epistemic communities or advocacy networks (Stone, 2004; Elkins and Simmons, 2005; Ball, 2012; Levi-Faur, 2005; Chwieroth, 2009; Fourcade, 2006). These consist of experts that share common ideas that were to be translated into policies, and found home in institutions such as the Bank for International Settlements, Basel Committee on Banking Supervision, International

[2]This literature draws on the structuralism/dependency theory that arose in the years after the end of World War II, following the footsteps of Raúl Prebisch's United Nations Economic Commission for Latin America and the Caribbean (see Prebisch (1962); O'Connell (2001)). Recent academic debates in economics discuss how the Mundell Fleming policy trilemma was transformed into a policy dilemma due to the constraints posed by international financial flows on domestic policy outcomes. Contributions show how the deregulation of the global financial system undermined policymakers' capacity to maintain control over the domestic the monetary and financial system (Rey, 2015; Coemert, 2013).

Monetary Fund, and World Bank (Moschella, 2010; Chwieroth, 2009; Johnson, 2016). Central bankers have been identified as forming a particularly tight transnational epistemic community that shaped policymaking by domestically translating dominant neoliberal ideas shared among them (Haas, 1992; Kapstein, 1989; Marcussen, 2006; Johnson, 2016; Maman and Rosenhek, 2007; Thomassen, 2017). These networks facilitated the dissemination of neoliberal ideas. In his seminal contribution, Hall (1993) analyzed how the rise of these ideas shaped policy change. Neoliberal ideas offered a convenient, readymade alternative to the Keynesian paradigm that informed policymaking during the Bretton Woods era but which lost support following a financial crises in the 1970s (Helleiner, 1996).

All of these strands argue that interests, institutions, and ideas work in the direction of policy convergence across countries. While providing important analytical insights that identify various mechanisms through which adjustment pressure is exerted, this literature lacks tools to explain cases in which adopted policies do not fulfill the expected convergence. This explanatory gap is present in all four selected cases, where convergence mechanisms sometimes work and sometimes do not work. Furthermore, even when there is presence of both convergence mechanism and policy convergence, the suggested causal mechanism may be insufficient for giving a full explanation: It leaves out the possibility that domestic governments enact agency through pursuing policy convergence *by their own choice*. Observed policy convergence can thus follow domestic strategic considerations that go beyond structural explanations offered by these theories. The case of central bank independence is illustrative in this regard: From a legal or neo-institutionalist perspective, policy convergence can be clearly identified, as the number of independent central banks in the world has increased continuously since the 1970s (Maxfield, 1997; Polillo and Guillen, 2005). But by following this analytical path, the questions whether these policy changes were inevitable and have served different functions are sidelined. In particular two relevant factors are left out: Regarding the independent variable, other factors that could explain the outcome, such as domestic considerations, are left out. Concerning the dependent variable, the relevance of individual policy changes (such as the introduction of central bank independence) can only be fully appreciated when accounting for the broader policy agendas of governments. The introduction of central bank independence, for example, may thus be not an objective in itself but only a strategic stepping stone in overarching institutional reforms.

In all four cases that are studied in this dissertation, governments' decision to increase central bank independence was part of a wider set of institutional changes that aimed at transforming the political landscape. Policy change followed rather specific government preferences, such as tying the hands of subsequent governments (Boylan, 2001) or breaking the power of bureaucracies (Vogel, 2006). Furthermore, central banks have continued to play multiple political functions that go beyond the scope of explanations offered by the convergence literature, indicating that they are one component in wider policy objectives of governments: conducting credit policies, promoting the development of capital and financial markets, and manipulating exchange rate movements. By accounting for variety of government motivations, this dissertation aims to enhance explanations of observed policy change.

All this goes without saying that the convergence literature offers strong explanatory power for understanding the broad overall trend to financial liberalization across countries since the 1970s. However, it serves only insufficiently to explain diverging policy change once financial markets were liberalized.

2.1.2 Divergence literature

As the convergence literature lacks mechanisms to explain variety of policies to manage liberalized financial systems, the divergence literature offers a more promising starting point. It can be broadly divided into one strand that focusses on the impact of predetermining domestic structures and one that focusses on domestic agency.

The next paragraphs will first review structuralist approaches and their limitations in explaining dynamic policy changes. Then the agency literature is introduced that spells out how governments can exert agency to shape policy responses to globalization pressures. This dissertation contributes to this strand by presenting *political empowerment of expert knowledge* as one mechanism that states can deploy to exert agency and shape policy change.

Structure The implicit assumption of the convergence theory is that domestic interests, structures, and ideas in less powerful states are subordinate to globalization pressures. The divergence literature presents theories that explain and illustrate how each of the three factors also work the other way around, explaining variety of policy change.

A prominent strand of literature concerns comparative political economy and varieties of capitalism. It presents a theoretical framework that shows how institutional variation across countries can be optimal as different institutional configurations create comparative economic advantages that self-stabilize themselves via path dependency (Streeck, 2010; Jackson and Deeg, 2008; Bohle and Greskovits, 2007). Due to the focus on equilibria and structures, the factors of politics, agency, and dynamics are largely sidelined in this strand of literature.[3]

Related contributions that analyze institutional reforms analyze how interests and institutions serve to hinder policy convergence and policy change. Walter (2008) analyzes policy reforms in East Asia after the 1997 crisis when states had to resort to international institutions for financial support and thus were required to commit to policy reforms that adhere to Western neoliberal norms. However, Walter finds that public and private interests, and institutions in these countries resisted to these imposed reform commitments, thus limiting the extent to which policy actually changed. A similar argument is provided by Culpepper (2007) who shows how legal change does not always correspond to practice. Also Rudra (2008) argues that policy convergence is less a result of global pressures than the desired outcome based on domestic interests. These studies show how domestic interests and institutions work as intermediating mechanisms for explaining policy divergence. While these contributions can explain why multiple institutional configurations can be optimal and why policy change is intermediated by domestic structures, they lack mechanisms that can explain the direction of policy change.

A number of contributions studied national and regional difference of ideas. One prominent scholar in this literature strand is Sheila Jasanoff who used the concept of *civic epistemologies* to study variety of ideas across countries based on national differences in understandings of what counts as knowledge (Jasanoff, 2011, 2007, 2005). Marion Fourcade (2009) documents how idiosyncratic domestic structures have resulted in different expert knowledge across countries. Gao (2000), in addition, shows how cultural specificities have limited convergence of policymaking in Japan - even after institutional reforms suggested otherwise. Campbell and Pedersen (2014) analyze how different structural conditions shape the evolution of national

[3]Note that there are two levels of stability and change involved in the varieties of capitalism literature. First, it makes institutional and policy divergence optimal due to comparative advantage. Second, within a chosen optimal path, divergence becomes less likely.

knowledge regimes and Elizabeth Thurbon (2016) shows how a shared developmentalist mindset of South Korean policymakers affected policy change. This strand offers an important theoretical contribution as it rationalizes why divergence in policymaking is to be expected based on the presence of different expert knowledge across cases. However, similar to interest-based and institutional explanations, knowledge as explanatory variable, from this perspective, is predetermined by existing domestic structures. These serve well to explain policy changes in the long-term, but not swift policy changes that are observed in the four cases studied in this dissertation.

Other contributions question the efficiency of mechanisms advanced in the convergence literature and identify the possibility of the state to exert agency to to counter policy convergence. Mosley (2006) uses the example of capital market liberalization through which global investors induce convergence pressure to illustrate this point. The convergence view posits that global investors can force countries, particularly less powerful ones, to adjust policies to neoliberal norms, as otherwise global investors would pull out their financial investments which in turn could impair economic growth and potentially lead to financial crises. Instead of stopping the analysis at this point where policy convergence can be identified (opening of domestic capital markets), she analyzes how this opening of capital markets is accommodated by newly adopted policies that can either strengthen the leverage of global investors over states (e.g. by establishing inflation-indexed bonds or introducing central bank independence) or improve state capacity to reduce the power of global investors (e.g. introduction of capital controls). By showing how global investors do not pay attention to all policy instruments deployed by the state, governments can use this leeway to pursue policies that oppose the interest of global investors and dominant states. Switching the analytical focus from dominant to less powerful countries, Mosley identifies state agency that can be exerted in response to globalization pressures - a critical gap in the convergence literature and in structuralist explanations of policy divergence.

Agency Although the structuralist strand of the policy divergence literature can explain why policies differ across cases, it remains largely deterministic and lacks explanatory power for explaining why certain policies were adopted and not others. Thus it serves only insufficiently for the objective of explaining the substance of policy change that is observed in all cases. The

cases of Japan and South Korea illustrate this: Following severe crises in the 1990s, governments in both countries introduced far-reaching institutional reforms that broke with path-dependencies. The developmentalist core of both countries (bureaucracies and financial institutions that are closely affiliated with large conglomerates) was dismantled by government-driven reforms that empowered alternative expert knowledge.

Which theories can thus explain these sudden policy changes? With a focus on states' capacity to develop policies independently from external factors, Linda Weiss attempts to generalize the conceptualization of state agency in times of globalization (Weiss, 1998). She criticizes the logic of the convergence argument that suggests there is no alternative for less powerful countries, which she coins "the political construction of helplessness" (ibid., 193) that renders state agency irrelevant (see also Hay (2007)). Instead, she argues that it is the government's choice to adopt policy that follow the convergence path - the empirical observation that a state pursues the convergence path is not sufficient in itself for substantiating the claim that there was no alternative to it that could have been selected. Weiss emphasizes that domestic choice in times of globalization can be retained through the development of new policies (Weiss, 2004; Vogel, 1996; Evans, 1995).

A range of contributions give further empirical evidence to this claim by analyzing the role of the state in shaping the impact of globalization pressures. Woo-cumings (2003) shows how South Korea's government conducted institutional transformations in response to the 1997 crisis that fulfill the expectation of the convergence theory - however she finds that practices did not change alongside (also Hundt (2014); Kong (2000)). Governments have maintained close control over the financial and economic system by the adjustment of existing and the development of new policy instruments (Kim, 2005; Thurbon, 2016; Rethel and Thurbon, 2019; Lee and Kim, 2017; Kim and Lee, 2006; Chu, 2009; Park, 2011; Kim, 2012f, 480). Kong (2012) shows that adjustment of Korean developmentalism has constantly occurred over the previous decades. He demonstrates how reforms undertaken by Korean governments did not contradict but instead transformed developmentalist policies. Similar empirical evidence is found not only for other less advanced economies (Weiss, 2000; Chibber, 2006; Schneider, 2009; Petry, 2020; Mëhilli, 2017; Mok, 2003; Cheng, 2003; Law, 2004; Gallagher, 2020; Nölke et al., 2014) but also in formally neoliberal countries in the Western world that have retained state interventions in the financial system (Chang, 2002; Monnet, 2018; Mertens and Thiemann, 2017; Mazzucato, 2013).

An ideational explanation that identifies agency for determining domestic policy outcomes is presented by Ban (2016) who shows how domestic translators create local hybrids that combine Western neoliberal ideas with local expert knowledge. Building on previous studies on local translations (Ban and Blyth, 2013; Carstensen, 2011; Acharya, 2009, 2004; Bockman and Eyal, 2002), he offers a compelling analysis that shows how policy divergence can be the result of domestic agency. Applying the concept of translation to the IPE/CPE literature, Ban advances arguments from the diffusion literature that lacks explanations for observed policy divergence. Using the factors of ideational legacies, critical junctures, and domestic institutions and international coercion, Ban demonstrates how domestic translators produce local hybrids. This dissertation complements this argument by analyzing the role of governments in accompanying the translation process, also in interaction with the factors identified by Ban. Instead of taking for granted the constraining role of structures that limit the extent to which domestic expert knowledge can be adopted, this dissertation analyzes in how far governments use *political empowerment of expert knowledge* as a source of agency to overcome structural impediments and inform policy change. Policy diffusion, in this perspective, serves more as a strategic resource to governments than an inevitable outside force that be domestically filtered at best. It thus picks up the lack of studies aiming to explain why and when ideas propelled by central banks affect policy output (Thomassen, 2017). ~~Nevertheless, structures retain a constraining role that limits the extent to which domestic expert knowledge can be adopted. This thesis complements the role of expert knowledge as source of domestic agency by analyzing how *political empowerment of expert knowledge* is used to overcome structural impediments and inform policy change.~~ This agency can result in direction of both policy divergence and policy convergence, depending on the type of expert knowledge that was selected. Focussing on agency of politicians and experts, this thesis links to contributions that focus on the agency of key policymakers in shaping institutional and policy change (Kingdon, 2013; Stiller, 2010).

The political selection of expert knowledge entails *political* and *expert* agency. By including this separation in the analysis, the power relation between governments and experts can be differentiated. This theoretical framework does not question that politicians can use their *political* agency to exert greater influence over policy outcomes than experts.[4] However, this shall not

[4]This thesis thus adopts a more critical stance towards contributions from the sociology

imply that there is no agency of experts ~~at all~~, which would imply a reversal of *ideas* as causal factor to one that is merely instrumental (see Blyth, 1997). Given the complexity inherent to the development of policies to manage a liberalized financial system, it is unlikely to assume that government leaders have the knowledge to maintain control over the *substance* of policies (although the degree of financial expertise of politicians diverges).[5] Governments instead delegate the task of responding to complex and technical policy problems concerning the international financial system to economic experts. Instead, governments develop the direction of policy agendas - this also entails the possibility that government leaders aim to increase their power by outplaying veto players, also within the state (for example the bureaucracy). It is here that *expert* agency is at play: While governments is in control over broader policy agendas, the specific features of monetary, financial, and foreign exchange policies are contingent upon the specific experts. Thus while political agency is expected to be more linked to wider institutional change, ~~it is expected that~~ experts can exert some degree of agency over determining the substance of policy change. The causal sequence thus flows from political agency to expert agency as the former produces situation in which the latter can be exerted. Independence that is linked to expert agency (and that is expressed in concepts like *central bank independence*) is in turn limited to the extent that it does not become inconvenient to the government: This dissertation explicitly allows for the possibility that governments will change the central bank governor if it becomes convenient for the government.[6] This differentiated, asymmetric relation between politicians and experts as policymakers aims at clarifying the explanatory function and sequence of *political empowerment of expert knowledge*.

The differentiation between institutional change and policy change does not undermine explanatory value of institutionalist, particularly of historical institutionalist accounts. While institutional inertia affects institutional change, policy change can be easier to be brought about. This points to

of knowledge as well as economic and financial sociology that emphasize the *performative* power of experts while largely excluding the role of politics.

[5]By analyzing the substance of monetary, financial, and foreign exchange policies, the empirical analysis goes beyond explaining why policy divergence is observed by identifying *how* policies differ.

[6]It thus does not take for granted the privileged role ascribed to central bankers in inducing policy change and institutional reforms according to their preferences (see Johnson, 2016; Thomassen, 2017)

	convergence literature	**divergence literature**
interests	dominant states, global investors	domestic interests, strategic instrumentalization
institutions	policy diffusion, structural dependencies	structural resistance, path dependency
ideas	transnational epistemic communities, political empowerment of expert knowledge	domestic knowledge regimes, domestic translation, political empowerment of expert knowledge

Table 2.1: Overview of theories explaining policy change

the relevance of differentiating the analysis between institutional change and policy change.[7]

2.2 Independent variable: political selection of expert knowledge

The argument that ideas matter for explaining policy outcomes is well-established (Beland and Cox, 2010; Blyth, 2012a; Braun, 2014; Carstensen and Schmidt, 2015; Chwieroth, 2009; Finnemore and Sikkink, 1998; Hall, 1989; Schmidt, 2008; Widmaier et al., 2007; Wood, 2015; Hirschman and Berman, 2014). Contributions range in-between a spectrum with the extreme points that on the one hand claim that ideas are merely instrumental for politicians (Goldstein and Keohane, 1993) and, on the other, that argue that ideas explain the constitution of interests (McNamara, 1999; Blyth, 2012a). Open questions remain *when* and *how* they matter.

[7]Some may argue that institutionalist literature does not aim at explaining policy change. As contributions like Culpepper (2007) and Walter (2008) indicate, there can be a difference between form (institutions) and substance (policies). However, institutions - like independent central banks and financial regulators - do imply the adoption of specific policies.

Going beyond the divergence literature's structuralist accounts of the role of ideas, this thesis demonstrates how governments exert agency by empowering expert knowledge to inform policy change (which can go in the direction of policy divergence and policy convergence). The supply of expert knowledge that governments can draw on goes beyond the policy networks established between politicians, domestic knowledge regimes, and transnational epistemic communities. Crises can result in the creation of new experience-based knowledge and governments can also appoint outsiders to consequential policymaking positions.

The important question of what motivates government leaders to appoint one expert over another is not in the analytical focus but nevertheless approximated in the empirical chapters. While some government leaders seem to be ideologically pre-committed and select experts accordingly, others followed strategic considerations that follow higher objectives like maintaining the stability of a dictatorship, supporting the transition process towards democracy, or propelling institutional reforms that strengthen the power of the government (which corresponds to the instrumental use of knowledge to legitimize political interests following Goldstein and Keohane (1993)). Particularly moments of crisis served as critical junctures where the projected need for policy change becomes apparent, as previous policies led to failure. A case in point would be Chile, where Pinochet's replacement of the orthodox neoliberal Chicago Boys from key policymaking positions after the 1982 financial crisis led to widespread public unrest that threatened the stability of his dictatorship. In reverse, the leader of the incoming coalition of democratic parties *Concertación* decided to withdraw from their original reform plans in order not to undermine the fragile stability after the transition to democracy.

The appointment of key policymakers is used to analyze the process by which governments empower expert knowledge to inform policy change. Using the case of management of liberalized financial systems, these key policymakers are often, but not exclusively, central bank governors. During the time when central banks were not independent, the key policymaker were primarily finance ministers. Although today central banks today are largely insulated from day-to-day political interference, governments can have a strong influence on policymaking by their capacity to appoint the central bank governor and policy board members. While there are certain legal hurdles that this appointment process faces (e.g. confirmation process in the parliament), it is a mechanism through which the preferences of the government can be

translated into policies to manage the liberalized financial system. This dissertation thus also speaks to the literature on central bank independence by highlighting how governments can shape central banking also when they are formally independent.

Variation of the independent variable is furthermore observed in terms of different expert knowledge that was acquired by the appointed policymakers, particularly given their exposure to knowledge transmitted in education and work life.[8] This expert knowledge becomes consequential as it offers guidance regarding the effects of financial flows in a country and the need for policies that are required to safeguard financial stability. One example for an opposing pair of expert knowledge that result in different policy outcomes is on the one hand knowledge that emphasizes the role of the state in controlling financial flows to safeguard financial stability and promote economic development (e.g. developmentalism), on the other one that underscores the benefits of free markets in allocating financial flows (e.g. neoliberalism) to achieve these objectives. Both approaches present consistent theoretical frameworks that identify causal mechanisms legitimizing the respective projected policy outcomes.[9] While both frameworks emphasize that their projected policies will enhance financial stability and economic development, introduced policies vary according to the projected causal mechanisms offered by theories. Of course these two types of expert knowledge are only examples, although prominent ones, among a multitude of options. An alternative type of expert knowledge is less theory-based and deductive, and more experience-based and inductive. While the advantage of the former is that it provides clear guidance based on a consistent theoretical framework, the latter brings the advantage that it can respond more quickly to changing circumstances.

Political strategies to make different types of knowledge consequential vary according to case-specific structural impediments. By analyzing the selection of key officials to inform policy change, the empirical chapters identify different strategies. In some instances, governments are closely linked to specific type expert knowledge based on existing policy networks. This is evident particularly in Latin America, where a major division line is between politicians that pursue developmentalist, state-led policies and those follow-

[8]For example, lawyers, applied economists and academic economists have very different world views regarding the benefits of liberalized financial markets and policies required for their regulation (Thiemann et al., 2017, 2020).

[9]These theories become performative when they are enacted by appointed policymakers.

ing neoliberal, market-led policies. But there are instances, where politicians drew on expert knowledge from outsiders to established structures to overcome resistance from their own party and/or the own voters. The appointments made by Prime Minister Koizumi in Japan and President Menem in Argentina are cases in points: These government leaders selected outsiders' expert knowledge with strong claims about the need for policy change to overcome crises that implied the need for turning away from the own voter base (Menem) or from large parts of the own party (Koizumi). In the instances of South Korea and Japan in the 1990s, government leaders had to overcome resistance of powerful bureaucracies to policy change. Only after prolonged efforts that included political scandals to weaken the bureaucracy's reputation, the use of expert commissions to devise policy proposals outside of established channels, and the replacement of staff governments were able to appoint alternate experts to key policymaking positions to inform policy change.

While the analytical focus of this dissertation is put on the role of expert knowledge as source of state agency, it does not assume that this is a straight-forward process in which other explanatory variables do not play a role. Governments do not act in solitude, and face structural resistance and competing interests in appointing experts to policymaking positions and inducing policy change, as structuralist strand of the divergency literature shows. By analyzing the political empowerment of expert knowledge as a moment in which agency is exerted, conditions are identified that are favorable to policy change, such as parliamentary majority that facilitates appointment processes or the use of crises to weaken veto players such as powerful bureaucracies or conglomerates. Two mains strategies deployed by government leaders were the use of expert commissions to overcome structural resistance (Japan, South Korea) and the development of alternative expert knowledge by the foundation of or linking with research institutions (Argentina, Chile). Within this tension between interests, institutions, and ideas, the selection of expert knowledge to inform policy change is subject to resistance.

2.3 Dependent variable: policies to manage financial liberalization

To analyze the translation of expert knowledge (independent variable) into policies (dependent variable), this dissertation examines three different but interlinked policy dimensions:

- **monetary policy** entails the policy rate (or quantitative monetary targets) to steer financing conditions, liquidity policies to stabilize the financial system (including the lender-of-last resort function), and credit policy to allocate financial resources to specific economic sectors.
- **financial policy** concerns, firstly, policies concerning the organization and development of the financial system, including the establishment and expansion of new capital and financial markets. Secondly, it entails financial regulation and supervision, including both micro-prudential (financial risks of individual financial institutions) and macro-prudential (financial risks concerning the whole system) aspects.
- **foreign exchange policy** covers the design of the exchange rate regime (floating, managed or fixed), interventions on foreign exchange markets, and accumulation of foreign exchange reserves.

These policy dimensions are interlinked and depend on each other. For example, monetary policy has only limited control over domestic financing conditions when foreign exchange policy does not manage destabilizing international financial flows. Other possible interdependencies would be that a lack of central bank instruments to fulfill its role as lender of last resort can increase the likelihood of financial crises, or that the opening of the financial system to international financial flows depends on the buildup of foreign exchange reserves to protect against excessive foreign exchange volatilities.

2.4 Case selection

The objective of the empirical chapters is to analyze the extent to and conditions under which the political empowerment of expert knowledge affects policy change. Thus, the selected cases require variance in the independent variable (expert knowledge) to explain differences in the dependent variable

(policy change). The four selected cases (Argentina, Chile, Japan, South Korea) fulfill this requirement, showing variety of both dependent and independent variables.

A direct comparison of these cases faces difficulties given significant differences in contextual variables, such as political system, industrial structure, interest groups, and the role of the bureaucracy and culture. The adoption of a nested-comparative design (most-similar nested in most-different) serves as an initial control for this issue. Contextual variables for the pair Argentina and Chile are relatively similar but contrast with the pair Japan and South Korea, which in turn are relatively alike in themselves. It is thus assumed that contextual differences for each pair of comparisons is justifiable.

If the theoretical expectations are supported by the empirical evidence of this first most-similar comparison, a most-different comparison between all four cases can be conducted. For this instance, it can be tested whether the effect of the independent on the dependent variable holds *even if* contextual variables differ. This would strengthen the validity of the causal mechanism presented in this dissertation and serves to identify conditions under which expert knowledge becomes consequential.

In Japan and Korea, the state was crucial in promoting economic development aiming at the production of higher-quality goods following the idea of catch-up industrialization from the end of World War II up to the 1980s/90s, when pro-market reforms were introduced (Amsden, 1989; Johnson, 1982; Rodrik, 2015). With relatively weak governments, it was primarily experts in powerful bureaucracies who guided this process in close coordination with the financial system and big conglomerates (*kereitsu* in Japan, *chaebols* in South Korea). The financial system was tightly regulated and subordinated to political guidance. In Chile and Argentina, states aimed to promote economic development following the idea of import-substituting industrialization in the period between the end of World War II and military coup d'états in the 1970s, when US-supported, right-wing dictatorships introduced neoliberal reforms to open the economy and the financial system (Sikkink, 1988). Presidents as government leaders have been powerful and controlled relatively weak bureaucracies. In both countries there have been numerous research institutions that support either left or right-wing policies.

All of the four countries accommodated to heightened international pressures to liberalize their financial systems following the end of the Bretton Woods system when the United States suspended the convertibility of the US dollar to gold in August 1971. With the end of this system, the primacy

of the state in controlling the economic and financial system was weakened, including the possibility to restrict international trade and financial flows, leading to a new era of financial liberalization (see Helleiner (1996); Ruggie (1982)). After an initial process of financial liberalization that was not accompanied by policies to protect the domestic system from new sources of risk, all of them experienced severe financial crises: Argentina and Chile in 1982, Japan in 1991, and South Korea in 1997. Based on this crisis experience, governments had to induce policy change to overcome the crisis and protect the country from similar future events. At this juncture, governments in the four cases opted for different expert knowledge and policies. The cases indicate that different structural conditions required different government strategies to induce policy change. In East Asia, institutional change was a pre-requirement to overcome resistance of powerful bureaucracies. Expert commissions played a conducive role for governments to empower new expert knowledge. In Latin America, the relative weak bureaucracies made government-driven policy change less problematic. The foundation of new and close linkages with existing research institutions by government leaders was conducive for developing expert knowledge which informed policy change.

By accounting for key insights of historical institutionalist, it is not assumed that the analyzed time periods in the empirical selection are independent from each other. History matters for policy change. More specifically, policy divergence occurred when a crises opened up windows of opportunity (Kingdon, 2013), based on which new policy paths opens up. The interpretation of the crisis and its impact on expert knowledge can affect future policymaking, as happened in Chile with the 1982 crisis, South Korea with the 1997 crisis or Germany with the hyperinflation of the 1930s.

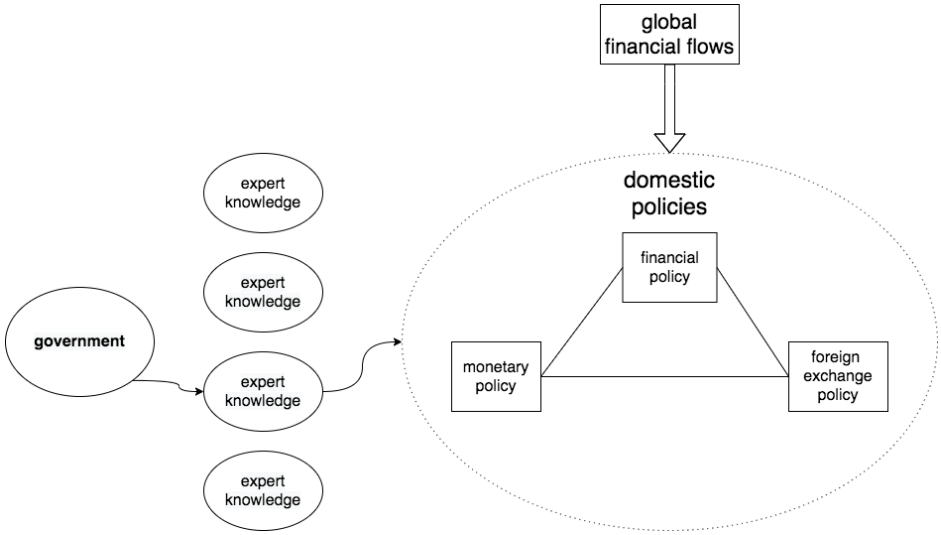

Figure 2.1: Theoretical model

Chapter 3

Methodological approach and data

In this study, causality is inferred from the comparative research design. The mechanisms through which the independent variable is expected to affect the dependent variable is derived from the theoretical framework. For the operationalization of the dependent and independent variables, a mixed-method approach is used. The dependent variable (policies) is identified by analyzing legal and regulatory documents that are complemented by other official documents (annual reports, financial stability reports, minutes of policy board meetings, and reports to the parliament) and by the use of descriptive statistics to show the effects of legal and regulatory changes. The independent variable (political empowerment of expert knowledge) is divided into two categories. Firstly, as the indicator for *political empowerment* is based on the political appointment of key policymakers, encompassing primarily central bank governors and finance ministers but also presidential advisors. These appointments follow different legal proceedings, but in all four cases it is the government head (prime minister, president, dictator) who makes the final decision. Secondly, key policymakers are used as the indicator for identifying and analyzing type and content of *expert knowledge*, based on qualitative and quantitative analyses of policymakers' speeches, their academic contributions (journal articles, books, interviews), and their CVs. These are complemented by central bank documents, encompassing annual reports, financial stability reports, minutes of policy setting committees, and reports to the parliament. Semi-structured interviews are used to triangulate the empirical findings and increase the validity of the inferred causality. This mixed-method approach

aims at enhancing both validity and reliability of the findings. The methods used are 'bread and butter' in social sciences. Also the type of data sources is nothing novel. The empirical analysis does however go beyond the focus of recent scholarship on ideas of monetary and financial policy in Europe and North America by using text data from central banks in Latin America and East Asia. Table 3.1 gives an overview of the main data sources.

Following the ideational turn in political economy, scholars have used documents such as speeches (Johnson et al., 2018; Moschella et al., 2020) or minutes (Abolafia, 2004; Moschella and Diodati, 2019) as data source to analyze policymaking. Increasingly sophisticated methods like topic modeling have enhanced the quality of analyses and reliability. While this study puts more focus on the qualitative dimension of text analysis to identify content of expert knowledge, quantitative analyses are used to triangulate the findings. Central bank governors are the primary figures of interest for determining the empowered expert knowledge, as they are the official representatives of the central banks. When they make statements, these are carefully crafted and reflect the representative stance of the central bank. The focus on central bank governors is due feasibility issues. The other members of policy setting committees are also appointed, but over a longer period of time. To analyze government interventions at certain points in time, it is sensible to focus on the central bank governor. In addition, speeches of central bank policy board members are accounted for since they have an effect on policy outcomes and may indicate the presence of challenging expert knowledge. One caveat applies: In some periods that were analyzed, the central bank was not formally independent and received guidance from the finance ministry. In these cases, the finance minister was the primary figure of interest.

Methods

Qualitative text analysis Qualitative text analysis of policymakers' speeches is used for distilling and analyzing expert knowledge. In these speeches, governors make clear statements about causal mechanisms that are, based on their knowledge, presumed to explain the functioning of the financial system and guide their policymaking. Based on these mechanisms, explanations for policy failures as well as undesired developments in the financial system and the economy are provided on the one hand, and policy prescriptions are derived on the other. The governors' conceptualization of these mecha-

nisms indicates whether the type of expert knowledge which can be of more academic (references to abstract concepts from economics with clearly identifiably, universal, and timeless mechanisms) or more experience-based type (reference to uncertainties, risks, continuous evolution of the financial system with mechanisms that change constantly).

Speeches of other central bankers in the policy board serve to provide indication for competing types of expert knowledge within the board that was, however, not selected by the government to inform policymaking. Conflicts within the board often emerge when policy change between different types of expert knowledge is conducted. Since other board members were often selected from previous governments, frictions are likely to occur.

Speeches were collected on central bank websites, the homepage of the Bank for International Settlements and the personal website of central bankers. Some speeches appear within other formats (e.g. annual reports). To increase reliability of qualitative text analysis, MAXQDA is used for coding the speeches. The coding system is divided into the categories *academic* (subcategorized in domestic financial system, international financial system, financial infrastructure, communication, structural reforms, monetary policy, financial regulation, developmentalism), *experience-based* (domestic financial system, international financial system, financial infrastructure, communication, structural reforms, monetary policy, financial regulation, developmentalism) and other categories *politics*, *society*, *coordination*, *history* and *epistemic limits*. For triangulation purposes, other central bank documents (indicated in 3.1) are used. Moreover, secondary literature and newspaper articles were analyzed to study empowerment strategies of governments.

Quantitative text analysis Qualitative text analysis has the advantage that policymakers' anticipated mechanisms concerning the functioning of the financial system and policies can be analyzed. Although quantitative techniques for text analysis has advanced rapidly over the recent years, it cannot (yet) distill *meaning*. Topic modeling, for example, can analyze relationships of words within texts, but qualitative analysis would be necessary to analyze what meaning these interlinked words create (in this case: what causal mechanisms are presumed to exist by governors). Moreover, there could be different reasons for why certain words pop up in certain times. For example, it is no surprise if 'financial stability' appears more frequently in central bank speeches after a financial crisis. Nevertheless, also crisis are 'constructed'

(Widmaier et al., 2007) and policymakers need to interpret what kind of crisis it is. Furthermore, the triangulation with qualitative text analysis serves to reduce the risk to misinterpret frequency and meaning.

Given its limited use for the analysis of the content of expert knowledge, quantitative text analysis is used in this dissertation to identify changes over time and triangulate the results of qualitative analysis. For tracing these changes in policy-relevant expert knowledge, the text corpora are subdivided according to the tenures of central bank governors. ~~The selected technique is straight-forward: The share of keywords indicating orthodox or pragmatic expert knowledge in the text corpus.~~

Semi-structured interviews Semi-structured interviews were conducted to increase validity of the analysis, both for the identification of the independent variable and of its anticipated effect on the dependent variable. Interviews with central bankers and bureaucrats from ministries of finance improved the analysis of how central bankers think the financial system works and what central banks can do to affect it. Academic experts as interview partners served for triangulation purposes as well as for enhancing the developments over time and the influence of politicians on policymaking. As speeches are carefully crafted representations of central bank positions, interviews served as valuable source of information for improving the understanding of the politics behind the speeches. This pertains to the process of political selection of central bank governors and the influencing by politicians on central bank decisionmaking.

A constraint of interviews as method is limited objectivity. This is not so much of a concern for the analysis of the independent variable, as the theoretical presumption is that expert knowledge differs from expert to expert and more a concern for statements about effects from the independent to the dependent variable. Evidence from interviews regarding these latter factors is only used when it is supported by other data.

Interview guidelines were maintained relatively open, following the logic of semi-structural interviews. Adjustments were made to account for historical specificities of the case, for different positions that an interview partner occupied over her or his career, and for cultural differences across the cases, especially between Latin America and East Asia. One main difference between these regions was the interviewee's readiness to talk about political issues. These aspects were discussed relatively open with interview partners

in Latin America. In Japan and South Korea, in contrast, interview partner struggled to talk about the politics of central banking. Only in some cases interview partners in East Asia were ready to discuss what happened behind the veils of carefully crafted official documents. The preparation and post-processing of each interview was linked with document analyses that concerned the activities of the interview partner. Interviewee-specific questions followed general question in the interview guideline.

Elite interview partners were identified and selected based on the position they occupied in the central bank or the bureaucracy. Interview partners reached from finance ministers/central bank governors to policy board members and department heads. Academic contributions and prestige served as selection criteria for expert interviewees. They were generally contacted via email. Given that potential interview partners are often in close contact, interview partners served as a source for identifying further potential interviewees and sometimes helped to get in contact with them. A problem for accessing potential interviewees in Asia was the language barrier, since English is not generally spoken. As the author of this study does not speak Korean or Japanese, the universe of potential interviewees was narrowed. This issue was less problematic for Latin America, since English is widely spoken among policymakers and as the author speaks Spanish reasonably well.

Interviews were audio recorded, except in those cases where the interview partner did not agree to it. References to the interviews are made under the condition of anonymity which was a preconditions for most interview partners. In rare instances, they did not agree for audio recording, also not under the condition of anonymity. In some cases, interviewees either asked to turn off the recorder when making some statements or explicitly stated not to use the information for the contribution. This type of collected information serves as background information that is not used explicitly in the thesis.

The total amount of recorded interview material is 1810 minutes. The length of interviews ranged from 36 minutes to 120 minutes, with an average of 72 minutes. All but four interviews were conducted in the context of field trips to Argentina and Chile in fall 2018, and Japan and South Korea in spring 2019. Two interviews were conducted in Italy, the remaining two were held online via video chat. Simultaneously, notes were written down and directly formed into a synopsis on the computer immediately after the interview. Interview transcriptions were facilitated by using the program *otter.ai*.

A second planned stay in Argentina and Chile in fall 2020 to conduct further interviews and access central bank archives had to be cancelled due to the COVID-19 pandemic.

Analysis of laws & regulations and descriptive statistics Descriptive statistics and the analysis of laws & regulations are used to identify the dependent variable. Both serve as data source to track whether expert knowledge was translated into policies and what effect this had for management of financial liberalization (e.g. changes in stocks and global flows of financial assets). Laws and regulations that establish policies are readily available on central bank and other specialized public websites.[1]

Descriptive statistics concern the balance sheet of the central bank, in which many policies are reflected. Moreover, global financial flows, domestic changes in financing conditions, and investment behavior can be traced with data provided by central banks, IMF, World Bank, BIS and OECD. This data is generally readily available, except for the case of Argentina. Although a database exists, it has not been accessible since 2020, thus limiting data access. Databases of international organizations served as alternative.

Further notes The empirical analysis was facilitated by the use of *Python*. PyCharm was used as integrated development environment. Programs written in Python were used to facilitate mass downloading of documents, preparation of documents for text analyses, translation of documents into English with Google API, and conduct of text analyses. The writing process of the thesis was conducted with LaTeX, using Texpad as editor.

Some speeches provided on central bank websites consisted exclusively or mostly of power point slides. These were excluded from the dataset. Some .pdf files were not recognized as texts, which required the use of Optical Character Recognition with Python and the program `newocr.com`. Other documents contained the same text in multiple languages, in which case all but the English version were eliminated.

For the case of South Korea, many speeches are not available in English but only in Korean. Furthermore, both speeches in Korean and in English were published in .hwp formats, which is a Korean text processor. Hence, to

[1] For Argentina: `http://www.infoleg.gob.ar/`; Chile: `https://www.bcn.cl/leychile/`; Japan: `http://www.japaneselawtranslation.go.jp/`; South Korea: `https://elaw.klri.re.kr/`

	Argentina	**Chile**	**Japan**	**South Korea**
Speeches	68 in English, 93 in Spanish (1998-2019)	157 in English, 208 in Spanish (2000-2019)	704 (1996-2019)	161 in English, 177 in Korean (1998-2019)
Interviews	4	7	9	7
Annual Reports	22 (1998-2019)	39 (1980-2019)	15 (2005-2019)	25 (1995-2019)
Minutes		256 (1997-2019)	311 (1998-2019)	109 in English, 133 in Korean (1999-2019)
Financial Stability Reports	32 (2004-2019)	32 (2004-2019)	30 (2005-2019)	30 (2005-2019)
Reports to the Parliament	26 (1993-2018)			
Monthly Bulletins		240 in Spanish (1981-1999)		

Table 3.1: Dataset

construct the Korean dataset, transformation of .hwp to .pdf and .txt had to be conducted for the empirical analysis. Furthermore, Korean speeches were translated into English to triangulate findings of the analysis of English speeches.

Although central bank documents and speeches have become popular objects of analyses in political science, these account mostly for Western central banks. Comparative studies and studies using this data source for non-Western countries remain limited, with the exception of a recent study on the Bank of Japan (see Katada et al. (2018)). Johnson et al. (2018) aim to make a transnational analysis of change in central banking by drawing on the BIS database of speeches. This database is however not complete and the number of available speeches is biased towards Western advanced economies. Furthermore, this thesis goes beyond the mere tracing of what central bankers *say* and also analyzes what they *do* in terms of policies.

With the start of Macri's presidency, Argentina new central bank website was launched in December 2015. Central bank speeches from previous presidencies were deleted and could mostly not be recovered. Thus alternative sources had to be used, including speeches that were integrated in reports to the parliament, and other publications by former policymakers such as journal articles, newspaper articles, and books.

Chapter 4

Chile

The analysis of the Chilean case serves to shed more light on agency exerted by the government to induce policy change and policy continuity. The government's selection of experts to key policymaking positions has been significant for explaining Chile's policies that were adopted to manage of its liberalized financial system. Motivations of government leaders to appoint key policymakers differed and were strategic, ranging from maintaining stability of the dictatorship under General Pinochet after the 1982 financial crisis to protecting societal cohesion in the transition to democracy under President Aylwin in the early 1990s. Existing structural constraints made some political choices more convenient than others but they cannot fully explain the substance of observed policy change.

Policies deployed by Chile's policymakers to manage its liberalized financial system can be subdivided into two distinct phases. The first phase was characterized by the dismantling of developmentalist structures and a lack of policies to manage the newly liberalized financial system following Pinochet's *coup d'état* (1973-1982). This was followed by a phase in which monetary, financial, and foreign exchange policies were introduced and adjusted to safeguard financial and economic stability subsequent to the 1982 financial crisis (1982-2020). Expert agency was exerted in the latter phase by developing policies based on the 1982 crisis experience. While policies converged to Western neoliberal norms in the first phase, financial stability-oriented policies adopted in the second phase diverged significantly.

Political agency in form of the selection of experts to key policymaking positions to induce policy change and policy continuity was exerted in three instances. The first instance occurred when Pinochet appointed the

neoliberal Chicago Boys to implement far-reaching policy reforms for the liberalization of the financial system in the mid- and late 1970s. Similar to the other three cases, the lack of policies to complement this liberalization process resulted in a massive buildup of financial imbalances, particularly in the form of foreign debt, that ultimately resulted in the devastating 1982 debt crisis. Although Pinochet's dictatorship was relatively powerful compared to Argentina's equivalent, the *Proceso de Reorganización Nacional* (1976-1983), the impact of this crisis resulted nevertheless in widespread public unrest that posed a threat to the stability of the regime. Under these conditions, the second instance of agency materialized: To calm the situation and stabilize the dictatorship, Pinochet decided to change key policymakers, replacing the neoliberal Chicago Boys with experts that had a less fundamentalist perspective on the financial liberalization and that were influenced by the experience of financial instability of the 1982 crisis. Particularly Pinochet's appointment of Hernán Büchi in 1985 to head the finance ministry was followed by the introduction of policies that imposed strict regulations on the financial system, particularly on international financial flows.

The third occasion where political agency was exerted did not result in policy change but in unexpected continuity of Büchi's policies. In 1990, the incoming government under President Aylwin (1990-4) that replaced the dictatorship in a peaceful transition of power decided against returning to developmentalist policies and appointing developmentalist experts to consequential policymaking positions as previously envisioned in blueprints for reform. Adopting the expert knowledge inserted by Pinochet after 1982, President Aylwin exerted agency as he perceived that policy continuity was necessary to prevent Chile from falling back to a state of instability and crisis. Subsequent governments have retained the consensus among politicians around policies introduced under Büchi and made only incremental changes to them without changing their direction to safeguard financial stability. This consensus was reinforced by a policy network that is based on close linkages between government and experts that are institutionalized in research institutions such as the *Corporación de Estudios para Latinoamérica* (CIEPLAN), which was founded in 1976 and is today presided by Aylwin's finance minister Alejandro Foxley.

The following section (4.1) analyzes how Pinochet appointed Chicago Boys to key policymaking positions for inducing policy change, resulting in rapid liberalization of the financial system in the 1970s. Next, Pinochet's turn away from the Chicago Boys and the appointment of undogmatic policies

for stabilizing Chile after the devastating 1982 crisis is examined (Section 4.2) that have been continued under the democratic governments following the transition in 1990 (Section 4.3). Section 4.4 analyzes in greater detail monetary, financial, and foreign exchange policies adopted to manage Chile's liberalized financial system. Section 4.5 concludes by discussing the role of other explanatory factors.

4.1 Chile under developmentalism and Pinochet's turn to the Chicago Boys in 1973

Political and economic instability characterized Chile in the three decades after the end of World War II that culminated into a large-scale attempt to reform the country by General Pinochet, who led a military coup to overthrow and assassinate left-wing President Allende in 1973. Tensions between the political left and right had been amplified against the background of the Cold War, resulting in frequent strikes, protests, imprisonment of political opponents, and a divided political landscape (see Collier (2004)). Recurrent inflationary crises and an omnipresent, powerful army further complicated the political landscape.

Governments in this period intervened heavily in the financial system to achieve the objective of economic development. The Economic Commission for Latin America and the Caribbean (CEPAL), established in Santiago in 1948 by the influential Raúl Prebisch, served as main provider of expert knowledge for informing the strategy of import-substituting industrialization that shaped policymaking in Chile and other countries across the continent (see Sikkink (2012)). The Economic Development Agency (CORFO), founded after the devastating Chillán earthquake in 1939, coordinated developmentalist policies and created various public companies, particularly for improving infrastructure and exploiting natural resources, to promote this industrialization process. Also the Chilean central bank (Bank) was subordinated to this strategy, which by decree from 1953 was to

> *encourage the orderly and progressive development of the national economy through credit and monetary policy, avoiding any inflationary or depressive tendencies, and thus permitting the maximum use of the country's productive resources* (BCC, 2019, 6).

However, in contrast to the cases of Japan and South Korea state interventions and public investments did not result in stable economic development. Instead misallocation of public money, such as strong expansion of a relatively inefficient bureaucracy and disproportionate investments in the production of basic consumer goods, resulted in high inflation and recurrent debt crises (see Collier (2004, 271-8)). Attempts to reduce fiscal deficits and enhance tax revenues such as under Jorge Alessandri's tenure as finance minister (1946-52) and president (1958-64), and President Ibáñez (1952-58) invitation of the US consultancy firm Klein-Saks to devise policy reforms in 1955 had only temporary effects and were met with strong resistance from parliament and public.

Political and social polarization that increased under left policies introduced by President Eduardo Frei (1964-1970)[1] further intensified under the presidency of Salvador Allende (1970 - 1973). Allende's adoption of socialist policies in the early 1970s, entailing strong restrictions of capital account movements, nationalization of companies (including copper mines and manufacturing companies), land reforms, and increases in public expenditures, resulted in a rapid buildup of debt, a large current account deficit and subsequently in a hyperinflation. Having won the popular vote with a narrow majority of 36.2 percent, Allende lacked strong backing and was further weakened by sanctions imposed by the U.S. under Richard Nixon who considered him as an enemy in the war against communism in Latin America (Schmitz, 2006, 94-111) When growing public dissatisfaction and widespread protests emerged over economic problems and further weakened Allende's government, the military took this as a convenient moment to intervene and overthrow the government.

Following the 1973 military coup against Allende, Pinochet implemented a strict authoritarian regime that aimed at a large-scale transformation not only of the Chilean financial and economic system but the society at large. Pinochet appointed several Chicago Boys, right-wing economists who studied under Milton Friedman at the Department of Economics at Chicago University or at the locally affiliated Catholic University in Santiago (*gremialistas*), to key policymaking position. And they used their far-reaching freedom to translate their neoliberal academic ideas into policies, resulting in heavy re-

[1] Among others, Frei strengthened unions, conducted land reforms, and established the National Planing Agency (ODEPLAN) in 1965 which was transformed to the Ministry of Planning and Cooperation in 1990 and Ministry of Social Development in 2011.

duction of state expenses, privatizations, and deregulating the financial and economic system (Valdes, 2003; Huneeus, 2000).

Given their utopian belief in the benefits and stability of free markets, the liberalization of the financial system in the 1970s was not accompanied by policies to regulate the risks arising from new options for Chilean banks, companies, and households to finance themselves on international financial markets. In combination with the adoption of a fixed exchange rate, these missing regulations encouraged speculative financial inflows to Chile given the high international interest rate differentials in the late 1970s. The idea of Finance Minister Sergio de Castro (1976-82) was that pegging the peso to the U.S. dollar would result in lower inflation rates, which was initially achieved. But similar to what occurred under Cavallo's *Convertibilidad* in Argentina, this peg resulted in an overvalued currency that fueled the buildup of foreign debt cheap and weakened the export sector, resulting in current account deficits and the rise of financial risks.

This rise of private foreign debt in the run-up to 1982 led to a massive financial crisis when Paul Volcker's Federal Reserve increased the policy rate to fight high inflation rates in the U.S. This reduction in the interest rate differential caused global investors to return their investments to the U.S.. After de Castro resigned in April 1982, his successor Sergio de la Cuadra decided to unpeg the currency in June 1982 after it was unattainable to be defended, resulting in a rapid rise of the relative foreign debt burden, making large parts of the financial system go bankrupt. The subsequent economic crisis destabilized the entire country, putting Pinochet under pressure to resolve this critical situation. Facing country-wide public unrest, including a number of union-led mass protests, Pinochet was pressured to implement policy change. At this critical juncture, he turned away from the academic Chicago Boys and adopted an undogmatic, experience-based approach to manage the liberalized financial system (see Silva (1991); Ffrench-Davis (2010); Caputo and Saravia (2018)).

4.2 Pinochet under pressure: undogmatic policy change under Hernán Büchi

Although some parts of the literature analyzing Chile's turn to neoliberalism do not differentiate between Pinochet's policies before and after 1982 (see

Fischer (2009)), this would miss how Pinochet's replacement of the Chicago Boys with undogmatic experts contributed to policy change after the 1982 crisis experience. To counter political pressure on Pinochet and tackle the financial and economic problems, Pinochet appointed Luis Escobar as minister of finance in 1984, who removed most Chicago Boys from their positions in the Ministry of Finance and expanded public expenditure (Bridges, 1987). Having served as minister under the Alessandri government and equipped with a graduate degree in public administration from Harvard University, his appointment initiated a clear break with the policy approach of the Chicago Boys.

Following a reshuffling of his cabinet in February 1985, Pinochet selected Hernán Büchi to become finance minister, who was linked to the Chicago Boys but carried the hopes to improve the dire financial and economic situation (País, 1985).[2] Büchi's educational background (he obtained degrees in mining from University of Chile and business administration from Columbia University[3]), his experience of the 1982 crisis while being chair of ODEPLAN and the financial regulator shaped his policymaking as finance minister, turning decisively away from Chicago Boys neoliberalism. His different expert knowledge is illustrated in critical comments on abstract economic theories represented by the Chicago Boys[4] and his emphasis on the benefits of experience-based expert knowledge that accounts for country-specific differences.[5] From his perspective, the objective of "free markets" can only

[2]Büchi was undersecretary at the Ministry of Economy (1979-80) under Sergio de Castro and undersecretary of the Ministry of Health (1980-3), where he worked with Jose Piñera on the 1981 pension reform (Roberts and Araujo, 1997, 32). During the crisis, he headed ODEPLAN (1983-4) before becoming Superintendent of Banks and Financial Institutions (1984-85) and subsequently Minister of Finance (1985-89).

[3]Columbia University was at that time home to heterodox and developmentalist economists who subscribed to theories emphasizing shortcomings of unregulated markets and problems of economic development of non-industrialized countries, including Albert O. Hirschman, Ragnar Nurkse, and Karl Polanyi.

[4]"I[Büchi] consider it a challenge befitting sensible politicians and reasonable experts —public servants with keen insights not necessarily acquired from books, but from experience, and who can apply those insights to their work. In this area, unyielding commitment to consistency, unbounded doctrinal zeal, and dogged ideological determination often cause more harm than good" (Büchi, 2010, 26).

[5]"Knowledge is essential regarding theory and practice, the broad lines and the detail, the historical background of problems and of the current situation. It is a thorough knowledge of things [...] that makes it possible to move the discussion from the ideological sphere to the practical one and find in-depth solutions, using creativity and common sense

be achieved by developing locally specific policies that stabilize them by restricting investment behavior.

Büchi adopted an undogmatic policy approach that underscored the importance of state interventions for recovering from the crisis, promoting economic development, and regulating a financial system that has a tendency towards instability. Addressing the problem of not having been able to solve the 1982 debt crisis earlier, Büchi criticized state inaction and noted that unregulated private actors are not able to cope with moments of uncertainty:

> *The main diagnostic error was to think that it would be possible to keep the state out of the problem that was developing. Private parties were unable to make the changes that the situation demanded, because they were not equipped to do so and because there were no laws or regulations stipulating how to cope with this contingency* (Büchi, 2010, 177).

Following a Keynesian logic, he emphasized that the state needs to act countercyclically to smoothen economic developments and regulate international financial flows to safeguard financial stability:

> *although the direct responsibility also lies with private initiative, government policy can make an important contribution [to promote investments]. In the first place, it must maintain a farsighted macroeconomic policy that smoothes out cycles of accelerated expansion and pronounced contraction in economic activity. In an economy such as Chile's, such cycles often originate in a balance of payments imbalance [...] relatively small variations in international interest rates can have a strong impact on the domestic economy* (Büchi, 1988b, 18)

Büchi translated these ideas into the 1986 General Banking Law and 1989 Constitutional Central Bank Act while strengthening the countercyclical Copper Fund, expanding public investments, and promoting the export sector. Demand and time deposit insurance schemes were introduced to prevent a bank run, the peso was continuously devaluated, and an exchange rate band was adopted (Büchi, 1985c,b, 3186). Furthermore, foreign investors

[...] Every country must determine a strategy and draw up a schedule to suit its needs" (Büchi, 2010, 38).

were subsidized for purchases of Chilean equity and debt (see Ffrench-Davis (2010, 117ff)).

Büchi's policies aimed at quickly resolving the crisis and pay back foreign debt at the full price (Büchi, 1985c, 3182). He considered it as very important to quickly repay foreign debt

> *based on the acknowledgment of the importance of maintaining a harmonious relation with the international financial community so as to take full advantage of the benefits of foreign trade* (BCC, 1988, 18).

Facing an illiquid financial system, private debt was nationalized, with the share of nationalized foreign debt reaching 86 percent in 1987 (Ffrench-Davis, 2010, 117). To finance this, the Bank issued long-term bonds (promissory notes) and received transfers from the Ministry of Finance.

To generate the income needed to pay back the debt, the government developed a strategy "to make exports the driving force of economic growth", coordinated by the public export promotion agency ProChile (Büchi, 1986c, 3098; Büchi, 1985a, 846). It was considered that

> *to maintain a high real exchange rate, which, together with moderate and even tariffs, constitutes one of the main tools to promote exports [and] is one of the bases to transform our productive structure towards an export economy* (Büchi, 1986a, 2464).

Beyond devaluating the peso and introducing tariffs on imports that "harm national production" (Büchi, 1986a, 2465) from 10 percent in 1982 up to 35 percent in September 1984, the government lowered policy rates, and increased public investments (BCC, 1987, 16; Büchi, 1986a, 2464). Companies with high growth potential, especially SMEs, were supported with tax breaks and other subsidies that were introduced with the Law for the Reimbursement of Non-Traditional Exports (Law 18480) and the General Banking Law in 1986 (Büchi, 1985c,d,a, 1986b,a, 3185). This "realistic debt policy" (BCC, 1987, 16) was aimed at meeting obligations to foreign creditors while supporting economic development by active state interventions.

Although Chile's government continued some neoliberal policies in the Chicago Boys tradition (such as privatizations), Pinochet's appointment of Büchi initiated a significant change of policies to manage the liberalized financial system. Monetary, financial, and exchange rate policies were deployed

to recover from the crisis and regulate Chile's financial system to prevent the buildup of financial risks (see Section 4.4). The recovery process was considered successful in achieving the objectives of paying back foreign debt and regaining financial stability (see Teichman (2001, 63,80)) As former governor Carlos Massad (2001a) recounts, "[after the 1982 crisis] there was a clear change in philosophy as the regulation and supervision of the banking system was profoundly reformed" (Massad, 2001a). All interview partners, independent from which end of the political spectrum, referred to the 1982 crisis as constitutional moment that has shaped expert knowledge and legitimized strong state interventions to safeguard financial stability. They expressed their conviction that these policy changes were crucial for the protection of Chile from future crises (Interview former Bank policymaker C, Santiago 5 October 2018; Interview Chile expert, Santiago, 9 October 2018).

4.3 *Concertación's* rejection of developmentalism and alignment with Pinochet's policies

In October 1988, the *Concertación*, a coalition consisting of more than a dozen democratic parties, won a plebiscite concerning the question whether to return to democratic ruling or to extend Pinochet's regime until 1996. With this, a transition process to democracy was initiated that was completed in March 1990 with the swearing-in of Patricio Aylwin, the leading figure of the opposition, to become president. While the coalition received solid backing (55 percent of the votes), it was relatively uncertain what this return to democracy would look like in terms of policies. Would it return to developmentalist policies as envisaged in the *Concertación*'s policy proposals in the late 1980s? Or would it continue Pinochet's policies to prevent a rekindling of political and social conflicts?

Aylwin chose a middle way, carefully navigating between stability and change to prevent that new policies would undermine fragile social relations and economic recovery, without disappointing the desire of voters for reducing massive social inequalities that built up in the dictatorship. This was not a self-explanatory outcome as Aylwin's Christian Democratic Party, which gained the most votes in the general election, had expressed its preference for more state interventions in the economic and financial system. Key policy-

making position were given to members of the *Corporación de Investigaciones Económicas para Latinoamérica* (CIEPLAN).[6] Most prominent of them was Alejandro Foxley who was appointed by Aylwin to become finance minister. In 1973, Foxley founded CIEPLAN, an institution spearheading the academic resistance to Pinochet's neoliberal policies and developing developmentalist policy alternatives to it that were informing the *Concertación*'s policy agenda in the late 1980s. Foxley was an outspoken critique of neoliberal policies of Pinochet's Chicago Boys, calling for a strong state to implement strategic, export-oriented economic planning - identifying the policy approach adopted by Japan and South Korea as role models (Foxley, 1987a, 79-84; Foxley, 1987b, 224-5; Foxley, 1982, ch. 4). Thus expert knowledge from CIEPLAN indicated a return to state-led policies similar to before 1973.

However, Aylwin and Foxley were aware of the need for restoring stability in a divided society and thus aimed at establishing a widespread consensus across the political spectrum (Puryear, 1994, 93; Boylan, 2001, 133; Silva, 1991). Foxley emphasized that the main problem of economic policy in Chile was not of technical nature but the lack of consensus in society (Foxley, 1982, 167). Moreover, the relative success of economic recovery in the late 1980s made it more difficult to legitimize significant policy change. Backing away from earlier criticisms and policy proposals, Foxley thus rejected a policy blueprint by his party committee that contained developmentalist policy proposals and instead announced that the government will continue economic policies that were inserted in the dictatorship (Boylan, 2001; Foxley, 1990, 105). Foxley legitimized this continuity of the post-1982 policy reforms as these were successfully in stabilizing Chile's economic and financial system:

> *The opposition economists, who were very critical of the economic management of the military regime, especially in the first ten years [1973-1982], have also learned the positive lessons that this management throws, fundamentally in its most recent phase [1983-1989]* (Foxley, 1990, 564).

Similarly, Aylwin stated that

[6] Among other CIEPLAN members taking public positions, René Cortázar became labor minister, José Pablo Arellano budget director, Mario Marcel budget sub-director (later Bank governor), Manuel Marfán coordinator of macroeconomic policies in the finance minister (later finance minister, CEPAL director, and Bank board member) (CIEPLAN, 2016).

> *[w]e may not like the Government that came before us, but they did many things right. We have inherited an economy that is an asset* (NYT, 1991b).

Facing a trade-off between the conviction of their own expert knowledge and the necessity of compromise to stabilize the country, Aylwin and Foxley decided to give up on the former.[7] This strategy was coined *growth with equity*: continuity of financial and economic policies, and change in terms of social policies to alleviate growing economic inequalities (Ffrench-Davis, 2010).

Policy continuity is reflected in monetary, financial, and foreign exchange policies. A case in point is the maintainance of central bank independence. In one of his last acts as dictator in October 1989, Pinochet introduced the Constitutional Central Bank Act (Law 18,840) in an open attempt to tie the hands of the *Concertación* for inducing policy change (Boylan, 2001). Unexpectedly, Pinochet offered some concessions concerning a rule for the appointment of members to the central bank's policy board: Two were to be selected from Pinochet, two from the *Concertación*, and one candidate who is considered to be neutral.[8] In December 1989, the compromise candidate Andrés Bianchi was selected to become central bank governor (NYT, 1989; LT, 2019), who was followed by Aylwin's candidate Roberto Zahler in December 1991. Many observers expected Ricardo Ffrench-Davis, who represented a more developmentalist monetary and financial policy, to become the new governor. But he lost political support when he denied to become board member in 1988, as he rejected to work for Pinochet (see Boylan (2001, 200)). Zahler was thus a less divisive choice. Although he was previously open to a more state interventions (Zahler, 1989), his policies introduced

[7]Also a number of other political decisions followed this compromise strategy: Although Aylwin established a Truth and Reconciliation Commission to investigate crimes that occurred during the dictatorship, the government largely abstained from prosecuting offenses of military officials. Moreover, the 1980 constitution (that is to be replaced in 2022 following a referendum in October 2020), Pinochet was given a senate seat for life and remained army chief until 1998, and several mechanisms have skewed the parliament to favor right-wing parties (Valenzuela, 1992).

[8]Interviewees remarked that this appointment logic has been continued until today, with two members representing center-left and two center-right, with one independent (Interview former Bank policymaker A, Santiago, 10 October 2018; Interview former Bank policymaker C, Santiago, 5 October 2018; Interview former Bank policymaker D, Santiago, 5 October 2018).

during his tenure Chile's central bank (Bank) followed the policy agenda devised by Aylwin and Foxley.

The stabilization of the policy consensus by the *Concertación* has been maintained until today. Only relatively minor scandals and tensions emerged among politicians and policymakers regarding monetary, financial, and foreign exchange policies. When Eduardo Aninat (finance minister 1994-9) set Zahler under pressure to lower policy rates, the latter decided to leave office in 1996 over a scandal revolving around Banco de Chile's debt repayments (Boylan, 2001, 130). Similar to Zahler, his successor Carlos Massad had been a proponent of a more interventionist role of the central bank (Massad, 1989) but did not pursue monetary easing. In May 2003, Massad had to leave office over a scandal concerning his secretary who illegally passed on information to the financial company Inverlink. Beyond minor scandals like these episodes and tensions over low economic growth between Finance Minister Valdés and Governor Vergara in the 2010s (Vergara, 2017; Mostrador, 2017), there were no attempts to induce large-scale policy change such as occurred repeatedly in Argentina or in Japan under Prime Minister Abe. Changes of the presidency, such as between socialist Michelle Bachelet (2006-10, 2014-8) and the conservative multi-billionaire Sebastián Piñera (2010-4), did not affect the policy consensus.

Also Pinochet's 1989 deal concerning central bank appointees has been maintained, although there are no formal institutional guidelines that would prevent the president from making partisan appointments. Presidents select the governor from among the policy board members that are appointed by the president upon confirmation by the parliament. Table 4.1 gives further support to the stability of the policy consensus, showing how central bank governors since Andrés Bianchi share similar backgrounds in education, job experience, and academic achievements. All governors share characteristics that they received graduate degrees from prestigious US universities, made stops at international organizations, domestic research institutions, and universities and made several academic publications. This way, Bank governors received legitimacy based on their academic study, close connections to international organizations and the United States.

The policy network among policymakers and government representatives was further propelled by institutional affiliations via organizations like CIEPLAN, CEPAL, and the Monetary Club of Finis Terrae University[9], but

[9]founded by Pablo Baraona who was Chicago Boy, minister under Pinochet in the late

Governor	Academia	Job
Andrés Bianchi 1989-1991	PhD at Yale University; professor at University of Chile and Pontifical Catholic University of Chile; published several academic articles	CEPAL, World Bank and IADB; Ambassador to the United States; president of financial committee responsible for determining investment policies of sovereign wealth funds
Roberto Zahler 1991-1996	PhD at Chicago University; professor at Chilean universities; published dozens of academic articles and books	World Bank, IMF, BIS, IADB and CEPAL
Carlos Massad 1996-2003	PhD candidate at Chicago University; professor at University of Chile; published multiple academic contributions	IMF, UN, World Bank, CEPAL; Health Minister under President Frei
Vittorio Corbo 2003-07	PhD at Massachusetts Institute of Technology; professor at universities in Chile, the United States and Canada; published multiple academic contributions	World Bank, IMF and IADB
José de Gregorio 2007-11	PhD at Massachusetts Institute of Technology; Dean of the Faculty of Economics and Business; University of Chile; various academic publications	BIS, Financial Stability Board, IMF, World Bank, IADB, UN and others; Minister of Economy, Mining, and Energy under President Lagos; president of financial committee responsible for determining investment policies of sovereign wealth funds.
Rodrigo Vergara 2011-16	PhD at Harvard University; professor at Pontifical Catholic University of Chile and Harvard University; published dozens of academic contributions	IADB, World Bank, IMF and UN; manager of Sebastián Piñera's successful campaign to become president in 2018
Mario Marcel since 2016	PhD in Cambridge University; professor at Cambridge University and several universities in Chile; published dozens of publications	World Bank, OECD, Inter-American Development Bank; Ministry of Finance, chair of commission for the reform of the pension system in 2006

Table 4.1: Background of Chile's central bank governors since 1989

also by frequently rotating positions in academia, politics, and the Bank.[10] Board members also changed positions between government and central bank, such as Manuel Marfán who was board member (2003-13), minister of finance (1999-2000), and sub-secretary at the minister of finance (1994-9). Academic collaborations within this network strengthened ties and shaped the academic discourse, such as joint contributions by Governor Carlos Massad and Finance Minister Nicolás Eyzaguirre (see Massad and Eyzaguirre (1990)), Bachelet's finance minister Andrés Velasco and Sebastián Piñera's finance minister Felipe Larraín (see Larrain and Velasco (2002); Larraín and Velasco (2000); Velasco and Larraín (1990)), Finance Ministers Eduardo Aninat and Alejandro Foxley with Budget Director José Pablo Arellano (Alejandro Foxley, 1980), and Governor Vergara and Finance Minister Larraín (see Larraín and Vergara (1992) and (Larraín and Vergara, 2000)). After a 2020 plebiscite determined the replacement of Pinochet's constitution by

1970s, and campaign manager of Büchi's bid for the presidential race in 1989

[10]Networks among politicians and Bank policymakers were also nurtured in other contexts, such as when later president Michelle Bachelet met Governor Mario Marcel (who had several responsibilities in governments between 1990 and 2010, including budget director (2000-06), pension reform under Bachelet (Marcel Commission) 2006, and returned in 2015 to become Bank governor under Bachelet), and finance minister Nicolás Eyzaguirre (who in turn was research assistant of Carlos Massad in the 1980s at Chile University and main advisor to Bachelet from 2015 to 2017) while temporarily working at different international organizations in Washington D.C. in 1998 (Cosas, 2007; LT, 2016).

2022, former finance minister Rodrigo Valdés and Vergara published a book to promote the translation of the policy consensus into the new constitution (see Valdés and Vergara, 2020). These collaboration go across party lines and were made before, during, and after their public service.

This continuity of expert knowledge and policymaking over time indicates how the *Concertación* had been successfully establishing a consensus around a set of policies that worked sufficiently well to safeguard the stability of Chile's financial system. Former Governor Roberto Zahler recalls how thinking about policymaking was aligned:

> *In the [Bank's policy board] there are no people who think A and other Z. Almost all of us went to the same university, we studied the same books and the great advantage is that we reached similar conclusions about how the macroeconomy works and how inflation is generated* (LT, 2018)

This alignment is also illustrated in the low degree of dissents within the policy board since 2000 (see Annex, Figure 4.1). Talking about the policy network, interviewees repeatedly pointed out that institutional stability was valued higher than partisan politics and personal interests, such as when Roberto Zahler and Carlos Massad left office to prevent harm to the institutional integrity or when presidents did not aim to make partisan appointments to the Bank's policy board.

These three instances (1973, 1982, 1990) demostrated how Chile's governments exerted agency to induce policy change and policy stability by selecting experts to key policymaking positions. The subsequent section analyzes in greater detail, which policies were introduced and how they were adjusted to manage Chile's liberalized financial system since the 1982 crisis, pointing to the relevance of expert knowledge in shaping policy substance.

4.4 Developing policies for maintaining financial stability

The previous section showed how the political appointment of experts to key policymaking positions resulted in significant policy change after the 1973 coup d'état and the 1982 crisis, and a continuation of policies under Aylwin's presidency that has been maintained until today. This section traces,

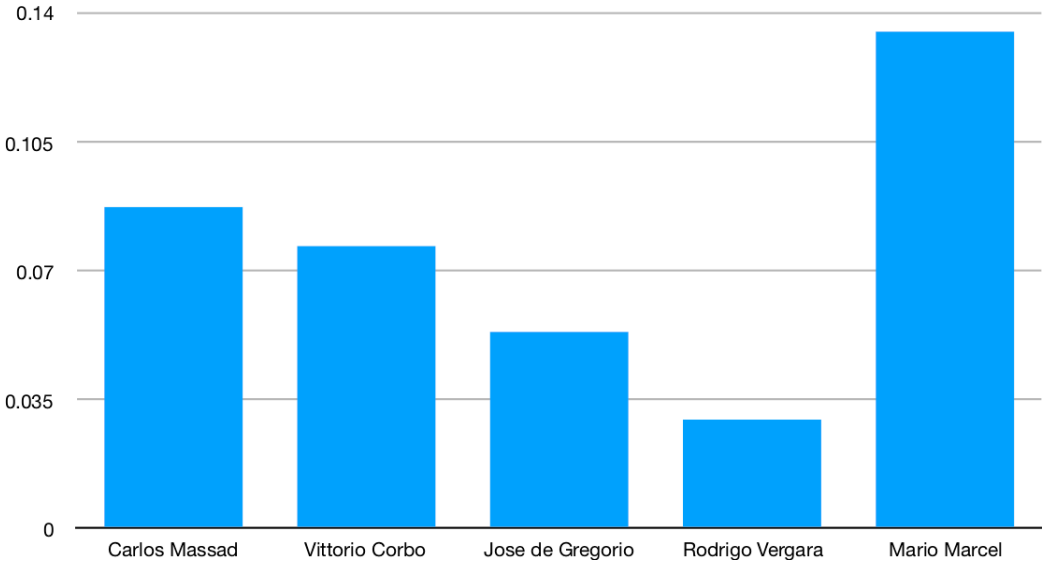

Figure 4.1: Dissents by board members of Chile's central bank concerning decisions made by the board (in percent)

firstly, how finance minister Büchi induced significant policy change in the 1980s and how this, secondly, served as the basis through which a policy consensus materialized in monetary, financial, and foreign exchange policies. It demonstrates how the 1982 crisis experience is embedded in this policy consensus and informs a policy approach to manage the liberalized financial system that focusses on the need for strict regulations to counter risks and volatilities inherent to the global financial system.

Recurrently referring to the 1982 crisis experience, policymakers across time and political spectrum have constantly been concerned of the financial system's tendency to instability. Identified sources of risks were particularly international financial flows but also new financial innovations and international linkages (Marcel, 2018; Claro, 2017; Zahler, 2016, 34-5; Marshall, 2014; Vergara, 2013a; De Gregorio, 2011; De Gregorio, 2010b; De Gregorio, 2009a; Corbo, 2005; Corbo, 2004a; De Gregorio, 2002; Massad, 2001b;Marshall, 2001; Massad, 1997b, 1184; Zahler, 1995a, 579; Zahler, 1995b, 2060; Büchi, 1985c, 3192; former Bank policymaker A, Santiago, 10 October 2018). Figure 4.2 shows how financial stability has been of higher importance than price stability among Bank policy board members, including a continuous focus on the financial cycle. Inflation has remained a prominent issue as it has

remained in the core of the central bank's legacy (see below).[11] . The alignment of expert knowledge around the need to safeguard financial stability was translated into monetary policy, financial policy, and exchange rate policy. Monetary policy has fulfilled the function to safeguard liquidity in the financial system and to promote development of domestic financial markets. Financial policy was deployed to control risk-taking behavior by domestic financial institutions and to develop deep domestic capital markets to reduce dependence on global finance. Exchange rate policies aimed at safeguarding financial stability by intervening in the foreign exchange market while supporting the export sector by preventing exchange rate appreciation. These policies departed from the convergence to Western neoliberal norms that informed Chile's policy approach before the 1982 crisis experience.

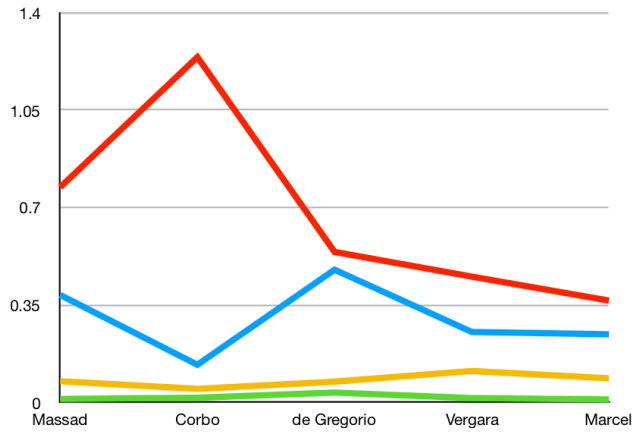

Figure 4.2: Frequency of word occurrence in speeches of policy board members of Chile's central bank, divided into tenures of governors: 'price stability' (green), 'financial stability' (blue), 'inflation' (red) and 'financial cycle' (yellow).

Core legislations that has shaped Chile's management of its liberalized financial system until today was the 1986 General Banking Law and the 1989 Central Bank Act as well as the pension reform 1981. Finance Minister, Büchi was the key official for their enactment of the former two, in the later case

[11] Although 'inflation' was more frequently mentioned than 'financial stability', its frequency of appearance has gradually decreased since Corbo's tenure. This is independent of the average inflation rate during the specific tenures: Massad: 4.3 percent; Corbo: 2.9 percent; de Gregorio: 3.6 percent; Vergara: 3.5 percent; Marcel: 2.7 percent.

he contributed to it as undersecretary in the ministry of economy (1979-80) and ministry of health (1980-83) (Roberts and Araujo, 1997, 32; González-Rossetti et al., 2000, 46, 68).

4.4.1 Monetary policy

Monetary policy after 1982 has been characterized by two principles: (1) strict abstinence from state financing and targeted credit allocation and (2) readiness to safeguard financial stability by providing liquidity. Principle 1 is a clear break with Chile's developmentalist era before Pinochet's coup d'état, when the Bank was the government's arm to shape economic development by allocating credit to targeted economic sectors. Recurring inflation and debt crises during this era were considered as a main lesson for the policy network to leave credit allocation to private actors. Principle 2 has been a consequence of the 1982 crisis experience, which illustrated how unregulated markets will tend to speculation and instability. Therefore, monetary policy needs to stand ready to inject liquidity in times of market volatility to prevent the financial system from collapsing.

Chile's constitution, adopted under Pinochet in 1981, states that any kind of state financing was outlawed (Art. 98). But only with the 1989 Basic Constitutional Act (Law 18,840, October 1989), prepared under Büchi, several safeguards to protect the central bank from government interference were introduced (principle 1). Independence is not absolute, however, as the Bank is required to account "the general orientation of the government's economic policy" (Bank Act, Art. 6(2)). Furthermore, the finance minister can attend and speak at policy board meetings as well as delay policy decisions up to 15 days and call for an extraordinary meeting (Article 19).[12] And as mentioned above, Chile's president has the right to appoint the five members of the policy board and appoint the governor from among them, upon approval of the parliament.

Principle 2 is anchored in Article 3 of the 1989 Act which established financial stability as the Bank's main objective next to price stability. For safeguarding financial stability, policymakers have different tools available to regulate liquidity conditions of both domestic and foreign currency:

- domestic liquidity: lender of last resort (Art. 36), and control over

[12] In all but 6 policy setting committee meetings since 2000, either the finance minister or one of his aides participated.

interest rates in banking sector and capital markets (Art. 35)

- global liquidity: repatriation and liquidation of foreign exchange stemming from exports of goods (Art. 42.1) and services (Art. 42.2); imposition of reserve requirements to foreign investments up to 40 percent (Art. 49.2); limitation of foreign currency holdings or investments denominated in foreign currency (art 49.5)

In the 1980s, the Bank provided liquidity to the domestic system by repurchasing foreign debts by Chileans (Chapter XVII), and allowing foreigners to invest in Chilean equity at a subsidized price (Chapter XIX) (Ffrench-Davis, 1990). Furthermore, the Bank issued central bank debt and provided exchange rate subsidies to commercial bank to repay their foreign debt (Barandiarán and Hernández, 1999, 23-25). These policies, following principle 2, aimed at stabilizing financial institutions that required state support to service their foreign debt.

After having regained stability in the financial system, Chile became the second country after New Zealand to adopt an inflation target regime in 1990. In May 1995, a shift to the daily interbank as policy rate was conducted to increase policy effectiveness and liquidity control in the financial system. (BCC, 1996, 23). It was considered to be "an additional step in the process of giving a more important role to the market in the determination of a macroeconomic price as fundamental as the rate of interest" (BCC, 1996, section D1), underlining the continued commitment to free markets by the *Concertación*. To improve the Bank's capacity to manage domestic and foreign liquidity in the financial system, various facilities and open market operations were introduced since the 1990s (see Table 4.2). Accounting for the need to provide liquidity not only to banks but also non-banks, the latter have become authorized for using open market operations offered by the Bank, including pension and unemployment funds, securities companies, mutual funds as well as stock brokers and securities brokers (Compendios de Normas Monetarias y Financieras, Chapter 1.3, Annex 1).

To reduce the risk that liquidity provision can result in state financing and violate principle 1, government bonds have not been used in open market operations and are generally not accepted as collateral to access central bank liquidity (Bank Act, Art. 27). Eligible collateral has been generally restricted to Bank securities but were complemented to accommodate the emergence of new financial risks, including the integration of bank mortgages and credit bills (2006), peso-denominated promissory notes, term deposit certificates

April 1998	Promissory Notes Indexed to Dollars (securities are denominated in USD but payable in pesos) were issued and repurchase agreements in US dollars established to develop longer-term foreign exchange coverage with a maturity of minimum three years
March 2000	Readjustable Coupons in UF and US dollars (CEROs) were introduced to improve market liquidity and foster the development of derivatives markets
July & August 2001	provision of Dollar-Denominated Promissory Notes (PRDs) to increase access to dollar liquidity against the background of volatilities on global financial markets
October 2001	foreign exchange swaps with banking and financial institutions were adopted to improve central bank control over liquidity conditions
August 2002	increased maturity of central bank securities (Central Bank Bonds in UF, pesos, and US dollars) to promote the development and liquidity of longer term domestic capital markets, and increase control over longer-term markets
October 2002	provision of Dollar-Indexed Bonds to improve foreign currency liquidity conditions
February 2004	Intraday Liquidity Facility was introduced to improve the provision of short-term liquidity to financial markets
January 2005	authorization of repo transactions with credit securities to enhance the market of credit securities
January 2005	liquidity facilities and repurchase programs were updated: establishment of the Liquidity Facility and Liquidity Credit Line in both domestic and foreign currency, and the 'Deposit Liquidity Facility' in peso
March 2006	acceptance of bank mortgages as collateral
January 2007	lowering of minimum term deposits
September 2008	reactivation of foreign exchange swap purchases
October 2008	introduction of a peso-denominated repo program
October 2008	allowing banks as well as savings and loan institutions to meet reserve requirements in foreign currency
late 2008	accepting time deposits, and bank mortgage bills as collateral
July 2009	introducing the new Term Liquidity Facility
December 2008 - August 2009	reducing the policy rate continuously from 8.25 percent to 0.5 percent
September 2012	announcement of development of a mortgage bond market to increase funding sources for banks and to create investment alternatives for institutional investors
September 2013	accepting mortgage bonds as collateral for open market operations, thereby increasing control over the market
May 2015	establishment of swap line with Chinese central bank, extended in 2018 and expanded in July 2020

Table 4.2: Policies adopted by Chile's central bank since the 1990s

and other bank-issued fixed income securities (October 2008), government bonds and bank time deposits (January 2009), mortgage bonds (April 2013), and government debt securities (December 2017). Additionally, stock brokers and securities dealers became eligible counterparties in early 2009. While government bonds were periodically accepted as collateral, the Bank was per law not allowed to purchase government bonds or securities issued by public institutions.

When the 2007 crisis hit insufficiently regulated financial markets in Western advanced economies, less advanced economies like Chile suffered from volatile financial outflows by panicking global investors. Direct effects on financial stability were however subdued, as policymakers had tools ready to provide liquidity in both domestic and foreign currency (see below). A number of policies were adopted by Governor de Gregorio to counter destabilizing international financial flows and smoothen liquidity conditions (Table 4.2). Many of these instruments were discontinued when the situation on financial markets calmed down in 2009/10. When new volatilities emerged, policymakers acted flexibly to safeguard financial stability, such as introducing a special liquidity program to facilitate the financial system's liquidity management in pesos to reduce potential risks from the Eurozone crisis (November 2012), and establishing programs for the increased provision of US dollar and pesos (December 2017). As nationwide protests emerged in late 2019, the Bank widened eligible collateral to include bank deposits and bonds, and established a dollar liquidity facility (via swaps, spot market, and derivatives market).

4.4.2 Financial policy

Parallel to changes of monetary policy, the 1982 crisis led to three significant financial-stability oriented changes of financial policymaking[13]: Strict financial regulation and supervision to prevent buildup of financial risks; the development of domestic capital and financial markets to decrease dependence on volatile global finance; and the establishment of public financial institutions and institutional investors that provide stable long-term investments. Policymakers perceived that these three pillars need to be in place to prevent financial crises in a liberalized financial system.

[13]Interview partners emphasized the experience from 1982 in informing financial policy (Interview former Bank policymaker D, Santiago, 5 October 2018).

Financial regulation Turning away from the Chicago Boys ideology after 1982, Finance Minister Büchi noted that strict regulation was necessary for a stable development of the financial system, including strengthened supervision of financial activities, more transparency, higher reserve requirements, and improved insolvency mechanisms (Büchi, 1985c, 3188-9). After the "improvised and hasty" liberalization of the financial liberalization in the 1970s (Zahler, 1993) that led to the 1982 crisis, Chilean policymakers since then have shared the conviction that this process needs to be "prudential and gradual", accompanied by new financial regulations (Zahler, 1992b, 2919; Zahler, 1992a, 2324; Massad, 2001a; Massad, 2001b; De Gregorio, 2002; Corbo, 2004b; Corbo, 2005; Vergara, 2013b; Zahler, 2016, 40; Marcel, 2018). As former Governor Massad put it:

> *In Chile, we have been able to learn important lessons from the past, so we have been carrying out a gradual and orderly transition process in the direction of learning to coexist with volatilities, a process that began some years ago* (Massad, 2000, 1794).

The following quote of Governor Zahler reflects the general conservative, experience-based attitude of policymakers in the management of liberalized financial markets:

> *It is essential to understand that financial capital movements have been, are and will be pro-cyclical. This means that the Central Bank's essential role is to reduce the impact of such movements on certain key macroeconomic variables. This is one of the main reasons for the nature of the restrictions in force and for their gradual relaxation. The simplistic assumption that total and immediate financial openness favors economic growth and the achievement of macroeconomic equilibrium ignores the experience of Chile in the not too distant past, that of other Latin American countries and even that of Southeast Asian countries* (Zahler, 1992c, 3189).

Also neoliberal Governor Vergara subscribed to this conservative approach, here when he was talking about lessons from the 2007 crisis in Western countries:

> *The costs of a crisis of this nature are high and long-lasting, so even at the risk of being mistaken, we'll rather be safe than sorry* (Vergara, 2011).

This shared conviction of policymakers is reflected in laws and regulations adopted since 1982. With the 1989 Basic Constitutional Act, the Bank became the macro supervisor and regulator with specific microprudential tasks. Bank's policies to fulfill these functions are established in the Compendium of Financial Regulations[14] and the Compendium of Monetary and Financial Regulations[15]. Further regulators and supervisors are the Superintendency of Banks and Financial Institutions (SBIF) and the Superintendency of Securities and Insurance (SVS), which were integrated to the Financial Market Commission (CMF) in 2019, as well as the Superintendence of Pensions (SP) for the regulation of pension funds. In 2011, the Financial Stability Council was established to coordinate the management of financial stability across these institutions and the ministry of finance.

The second core legislation next to the Bank Act has been the General Banking Law from 1986 (Law 18,576, November 1986). It established a strict regulation of the financial system based on the experience of the consequences of financial liberalization under the Chicago Boys. This law tightly regulated bank lending behavior, reduced interconnections within the banking sector as well as between the banking sector and other financial sectors (see Table 4.3 for an overview of regulations) The regulation of international financial flows was central to it, with an emphasis on the regulation of currency mismatch and limits to foreign debt for companies in the non-tradable sectors (Interview former Bank policymaker D, Santiago, 5 October 2018).

When financial inflows returned to Chile in the early 1990s, policymakers put a special focus on the reduction of short-term financial inflows that harm the export sector and are linked to more financial instability (Massad, 1997a, 2089) and "systematic risk" (BCC, 1994, 32). One interview partner noted:

> *In the 1990s I would say in the economic themes of Concertación, it was very present the big crisis of 82. [...] Too much inflows. They pushed the change rate to appreciation, they put imports up, they deterred exports* (Interview former Bank policymaker B, Santiago, 4 October 2018)

[14]This compendium entails regulation of capital markets and financial markets, concerning mortgage operations; ratios between assets and liabilities of banks; bank liquidity management; foreign investments by banks as well as pension fund; insurance companies and unemployment fund; and derivatives in local markets.

[15]This compendium entails regulations of banks' access to central bank liquidity and liquidity regulation of banks.

Article 69	compartmentalization of the financial system, listing explicitly which services financial institutions can offer, for example preventing banks from engaging in risky activities such as derivatives trading or equity investments
Article 84	5 percent limit to loans to the same borrower (10 percent if it concerns foreign currency loans for export financing, up to 30 percent if it is secured by tangible assets)
Article 84	Loan classifications further regulated the investment portfolio of banks and interbank loans were restricted up to 30 percent of capital and reserves of the lending bank
Article 84	Intra-bank lending was strictly regulated, including limiting loans to own employees to 1.5 percent of capital, prohibiting lending to any person owning more than 1 percent of the bank and banning any loans to bank managers and their relatives
Article 65	10 percent limit to ownership of a bank
Article 80	liquidity ratios of banks
Article 83	maximum limit of foreign investments to 100 percent of capital and reserves, including 25 percent of capital and reserves invested in foreign banks; foreign banks may only invest up to 25 percent of their capital in Chile: investments in foreign banks need the approval of the financial regulator (SBIF) and the central bank
Article 13	loan classifications regulated the investment portfolios of banks
Title XV	insolvency mechanisms

Table 4.3: Selected regulations of Chile's 1986 General Banking Law

Introduced in June 1991 under Roberto Zahler, the unremunerated reserve requirement (URR) was the Bank's flagship tool used to manage the inflow of short-term capital, which required up to 30 percent of it to be deposited with the Bank for one year with no interest. When the risk of massive capital inflows from abroad reduced, Massad discontinued them in September 1998 (Massad, 2003). While direct capital controls were not used since then, more indirect forms were adopted to regulate financial inflows, such as a 35 percent capital gains tax on foreign investment in domestic bond markets that was discontinued only in May 2014 (Figure 4.3, OECD, 2011, 41; IMF, 2014).

Having observed the currency speculation around the Asia crisis 1997, policymakers introduced a floating exchange rate and capital account liberalization, and promoted the development of derivatives markets to allow corporations to hedge foreign exchange risks. Furthermore, a range of safeguards were maintained to regulate risk-taking as financial regulations became the only restriction left to control risk-taking of financial institutions (Marshall, 2001; see also Marshall, 2002). To accommodate changes of global financial system, a number of new regulatory instruments were adopted since the late 1990s (see Annex, Table 4.4). As current Governor Marcel put it:

> *it is important to minimize financial exposure to [exchange rate] risk. This involves curtailing currency mismatches in government, business, and bank balance sheets through regulation and*

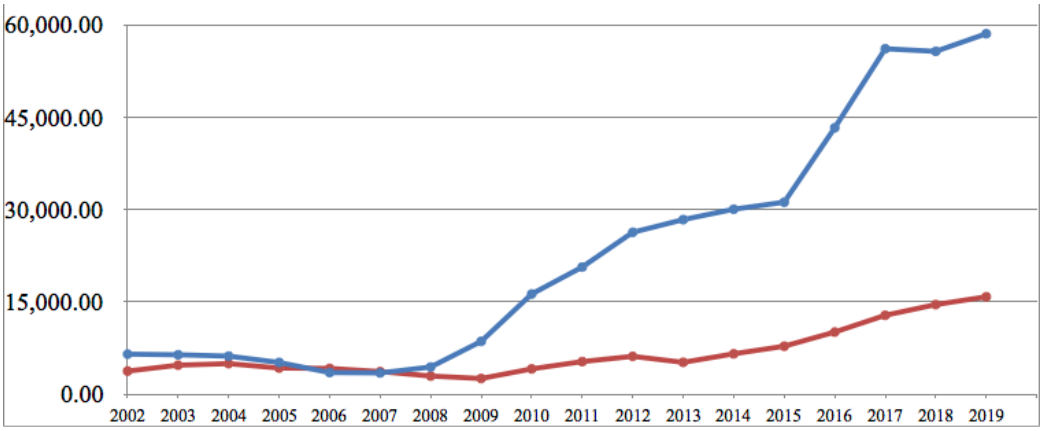

Figure 4.3: Chilean sovereign debt securities held by foreigners (red) and locals (blue) (USD million), source: Banco Central de Chile Statistics Database, Debt Stock by Instrument, Central Government (Millions of USD)

late 1990s	adoption of Macroprudential tools in to counter rising financial risks stemming from a rise in household debt
October 2003	introduction of regulations on maturity mismatches
February 2006	introduction of regulations on non-bank credit cards
January 2015	introduction of regulations on liquidity risks following Basel III
January 2016	introduction of mortgage provisions
January 2019	new capital requirements and bank resolution following Basel III

Table 4.4: Chile's new regulatory instruments adopted since late 1990s

> *the use of market hedging mechanisms, like [foreign exchange] derivatives* (Marcel, 2018).

The crucial role of the tight financial regulation for managing the liberalized financial system was highlighted by all interviewees. One emphasized that "the banking regulation is super tight" with a low degree of complexity of banks, adding that the "financial sector, the banking system in particular, is very strongly supervised, strongly regulated, especially in terms of liquidity"(former Chilean minister B, Santiago, 16 October 2018). And another interview partner added:

> *we [policymakers] had made the homework from the point of view of building a very, a very strong system of regulation, supervision of the financial system. After the crisis of the early 80s we*

> *had not have any major crisis in the financial system, including during the great financial crisis of the last the year in 2007/2008, we didn't have any problem with the Chilean financial system because banks are well capitalized, well regulated. We monitor very closely open position in the foreign exchange, they had to report by Chilean law, they had to report in the financial statement and that has to be audited that they don't have open positions. Or they have to report the size of the open position* (Interview former Bank policymaker D, Santiago, 5 October 2018)

Public financial institutions, institutional investors, and the development of domestic capital markets Institutional investors and public financial institutions were established and have been used since the 1980s for safeguarding the stability of the financial system, accumulating and managing foreign exchange reserves, and promoting the development of domestic financial markets. These functions were perceived to be central for achieving the shared objective of Bank policymakers to reduce Chile's dependence on foreign finance (Büchi, 1985d, 3175; Büchi, 1985b; Zahler, 1995a, 579; Marshall, 2000, 69-70; Marcel, 2019b).

With the 1981 pension reform, private pension funds (AFPs) were established that since then have grown to become the most important vehicles for promoting Chile's capital markets (former Bank policymaker A, Santiago, 10 October 2018; see also Büchi, 1986c, 3107). By end-2019, their total assets under management reached 80 percent of Chile's GDP by end-2019 (Figure 4.4), around 85 percent of all outstanding corporate bonds were held by institutional investors (Marcel, 2019b) and they are a major holder of public debt (Figure 4.5). In addition to this task of mobilizing domestic savings, AFPs have become important accumulators of foreign assets since 1990, when regulators began lifting limits on foreign investments from 1.5 percent in 1992 up to 80 percent in November 2010 (Figure 4.6). Also limits of insurance companies' foreign investments have been increased to up to 30 percent in March 2017. In times of volatility on international financial markets such as in 2007/08, institutional investors were induced to react countercyclically to international financial flows, including by acting as counterparties on local derivatives markets (De Gregorio, 2008, 9; Marcel, 2019a; De Gregorio, 2009b; Vergara, 2013c; Vergara, 2014a; Marcel, 2017; Marcel, 2019b; Marcel, 2019b; see also Figures 4.7).

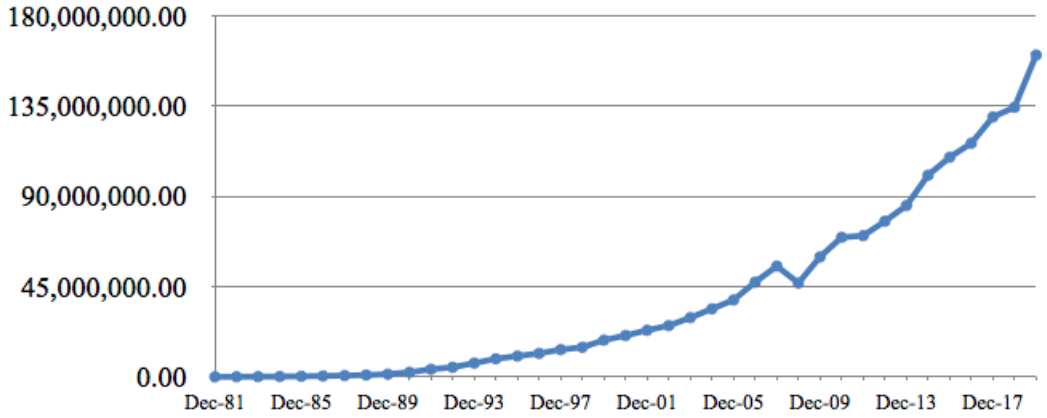

Figure 4.4: Chile's private pension fund investments (CLP million), source: Superintendencia de Pensiones

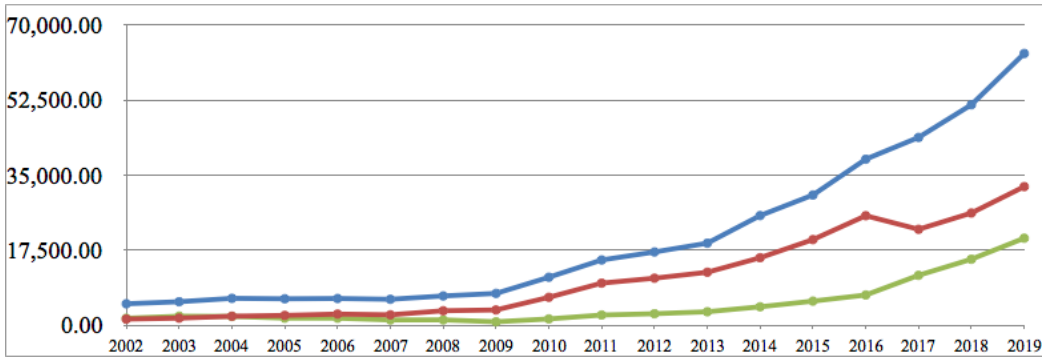

Figure 4.5: Chilean government bonds (blue), held by pension funds (red) and foreigners (green) (CLP billion), source: Banco Central de Chile Statistics Database, Debt securities by counterpart sector, outstanding amounts, reference 2013

Given their strong presence in domestic capital markets, institutional investors were together with the Bank key factors for their development. Similar to the case of Korea after the 1997 crisis, the Bank actively promoted this development after the 1982 crisis as its issuance of debt securities offered a stable supply of long-term investment opportunities that was demanded by institutional investors. Also in the 1990s and 2000s, the Bank issued new debt securities and widened eligible collateral to sterilize foreign exchange interventions (see below) and to shape maturity and currency structures of

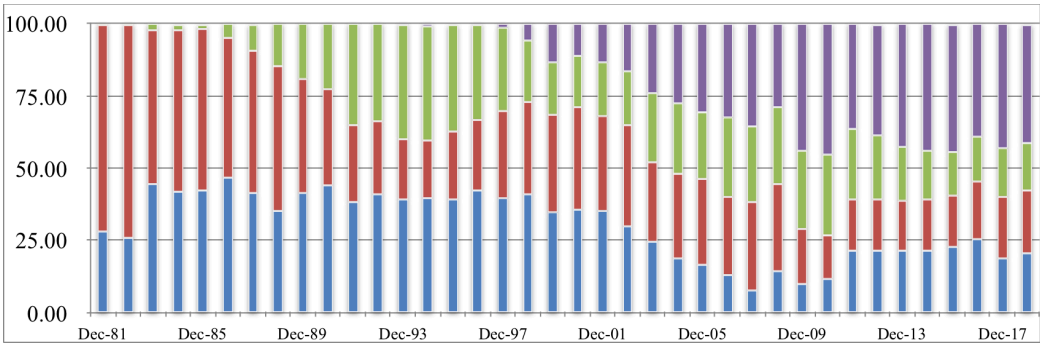

Figure 4.6: Composition of Chile's private pension fund investments: securities of public sector (blue), financial corporations (red), non-financial corporations (green), and foreign investments (purple) (percentage), source: Superintendencia de Pensiones

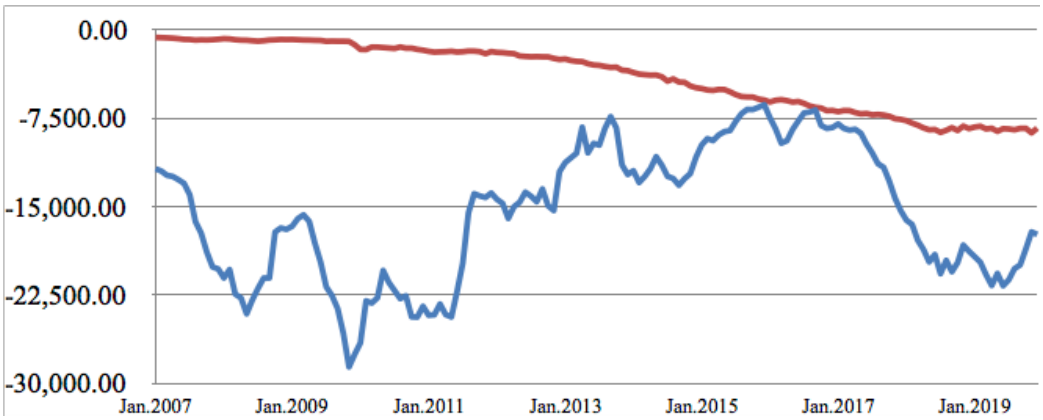

Figure 4.7: Net derivatives position of Chilean pension funds (blue) and insurance companies (red) in local market (domestic currency against foreign currency, USD million), source: Banco Central de Chile Statistics Database, Derivatives net amount outstanding with FEM

the capital markets (see table 4.2). Notably, the Bank promoted the use of inflation-indexed securities (*Unidad de Fomento*) to increase investment confidence since the 1980s (see Jadresic, 2005).[16] By issuing this range of

[16]Large parts of Chile's financial system and policy tools are indexed to the *Unidad de Fomento*, offering increased stability in asset values. As Bank policymaker Jadresic stated, "the the executive, legislative and judicial powers have always respected [the *Unidad de*

securities, the Bank offered safe liquidity access to financial institutions and thereby reduced risk of financial institutions. Tax and legal reforms to ease regulations in 2001 (MKI), 2007 (MKII) and 2010 (MKIII) further propelled growth of capital markets (Figure 4.8).

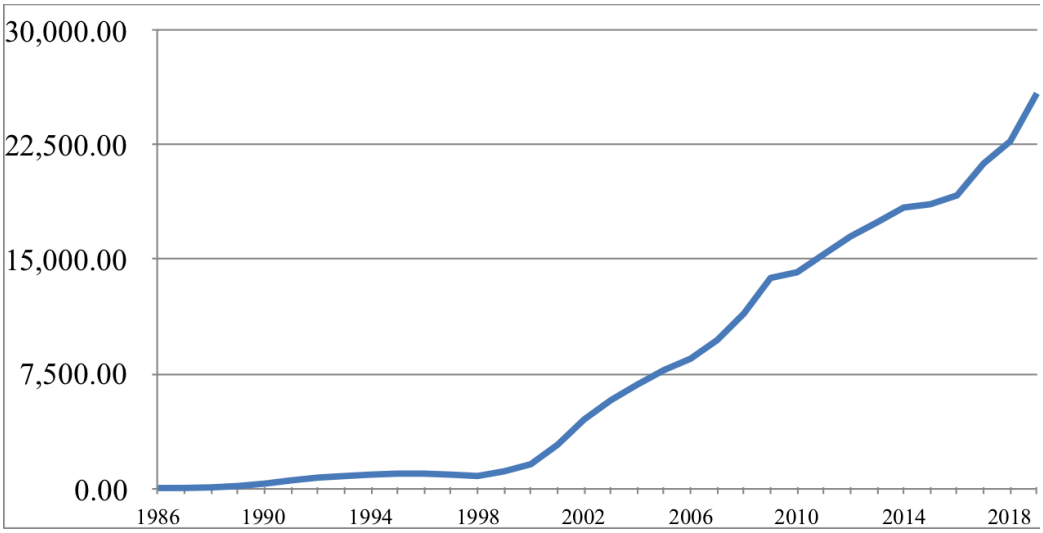

Figure 4.8: Development of Chile's corporate bonds outstanding (CLP billion), source: Banco Central de Chile Statistics Database, Monetary aggregates and their components –averages

Beyond institutional investors, public financial institutions have become central pillars as foreign reserve accumulators. The establishment of Chile's sovereign wealth funds is closely interlinked with tight restrictions on public expenditures that has characterized Chile's policymaking since the 1980s against the background of the experience of public debt crises during Chile's developmentalist past. Referring to a "culture of sound fiscal policy" that has been established, a former Bank policymaker stated:

> *Why is Chile so strict with fiscal policy? [...] We have a long history of irresponsible fiscal policy in the 60s, 70s, etc. [...] we need to have a sound macro environment and that includes both solid fiscal policy, sound fiscal policy, and also sound monetary policy* (Interview former Bank policymaker A, Santiago, 10 October 2018)

Fomento] religiously" (Jadresic, 2005).

This thinking was institutionalized with the adoption of a fiscal policy rule in 2001.[17] In September 2006, the Fiscal Responsibility Law (Law 20,128) strengthened the legal status of the fiscal policy rule and since then requires governments to annually present their budget.[18]

The Fiscal Responsibility Law created the Economic and Social Stabilization Fund (ESSF) and Pension Reserve Fund (PRF). Their investment policies are determined by various key officials in the Sovereign Funds Investment Committee (est. 2007), including by its current director and former Governor de Gregorio. The ESSF is also tasked with the objective to lend countercyclical stability to the economy such as during the 2007 crisis (Vergara, 2014b). All of its assets are external and have oscillated around USD 14 billion. The ESSF replaced the Copper Stabilization Fund in March 2007, which was founded under Büchi in 1985 to accumulate foreign exchange reserves, reduce dependency on copper exports as well as to stabilize the foreign exchange rate and the fiscal balance (Büchi, 1985c, 1385; Büchi, 1988a, 1203; Carrasco, 2009, 199-200; IMF, 1992; WB, 1985). Next to the ESSF, the PRF was established in December 2006 (assets increased from USD 1.5 billion in 2007 to 10.2 billion in 2019).

4.4.3 Foreign exchange policy

Given the focus on risks attached to international financial flows and the 1982 crisis experience, Bank policymakers paid special attention to foreign exchange policy to counter destabilizing developments, particularly those linked to currency appreciation and liquidity shortages. This concern was

[17]This rule was adopted by Lagos government with the Maastricht criteria as model in mind to reduce fiscal discretion (Marcel, 2013, 3-4). It was developed by several key officials such as Mario Marcel (budget director that time), Vittorio Corbo, and Rodrigo Valdés, with support by other policymakers like Joaquín Vial and Manuel Marfán as well as financial regulator Guillermo Larraín and Minister of Finance Alberto Arenas (Hacienda, 2001; Marcel, 2013).

[18]The Advisory Committee for the Copper Reference Price is estimating the price development of copper used to inform the current fiscal policy rule, thus setting boundaries to state expenditures. Various key policymakers took positions in this committee, including current Bank Vice-Governor Joaquín Vial, Mario Marcel, or current board member and former Budget Director Rosanna Costa. In 2013, the Fiscal Advisory Council was founded to advise the government on budgetary issues, among its members have been former conservative Bank employees such as Klaus Schmidt-Hebbel. It was replaced in February 2019 by the Autonomous Fiscal Council, currently headed by the conservative former Bank official Jorge Desormeaux.

institutionalized not only in General Banking Law (see above) but also prominently in the mandate established in Article 3 of the Bank's Constitutional Act:

> *The Bank shall have as its purposes to look after the stability of the currency and the normal functioning of internal and* **external payment systems**.

Art. 49 of the Bank Act equips the central bank with a range of options to actively counter international capital flows that undermine its objective of financial stability. The Bank's Compendium of International Exchange Regulations establishes the corresponding policy tools. As mentioned above, regulations were gradually loosened over the 1990s, culminating in the adoption of a floating exchange rate in 1999 and the further opening of the financial account in 2001.

With the consequences of the fixed exchange rate in mind that fueled the buildup of foreign debt in the run-up to the 1982 crisis, policymakers aimed at gradually liberalizing the exchange rate. A floating exchange rate band of 2 percent was adopted in 1983, which was expanded to 3 percent in 1988, 5 percent in June 1989, and 10 percent in January 1992 (see Ffrench-Davis (2010, 123)). Nevertheless, the Bank determined in March 1992 that it can intervene also within the band "when it considers that by doing so it can avoid undesirably sharp exchange-rate fluctuations" (BCC, 1993, 62). This way, the exchange rate was controlled and devalued continuously (see Zahler (2016, 38) and Figure 4.9). Periods of strong financial inflows, in the 1990s, 2000s and 2010s were responded with foreign exchange interventions that led to the buildup of foreign exchange reserves. These reserves in turn were perceived as self-insurance against volatilities linked to international financial flows such as experienced during the Mexican peso crisis in the mid-1990s (BCC, 2006, 5; Zahler, 1995a, 579; De Gregorio, 2010c; De Gregorio, 2010a; Marcel, 2018). As the Bank Annual Report 1994 stated:

> *All the evidence seems to indicate that the abundant capital flows to Latin America during this decade will not continue [...] and a plentiful stock of reserves is the best possible shield against a coming period of relatively short supply of external financing* (BCC, 1995, 27-8)

The accumulated reserves then helped the Bank to inject foreign liquidity when the exchange rate was under pressure and shortages of foreign liquid-

ity emerged in domestic markets. Since the official adoption of a ”floating exchange rate regime” in 1999, the Bank intervened punctually in the foreign exchange market, but without expressing Chile’s preference concerning export competitiveness (Table 4.5). Figure 5.5 shows the buildup of reserves over the 1990s and again following the 2007 financial crisis. Furthermore, while controls have not been used since 2001, the Bank has maintained the capacity to deploy capital controls when it considers this necessary.

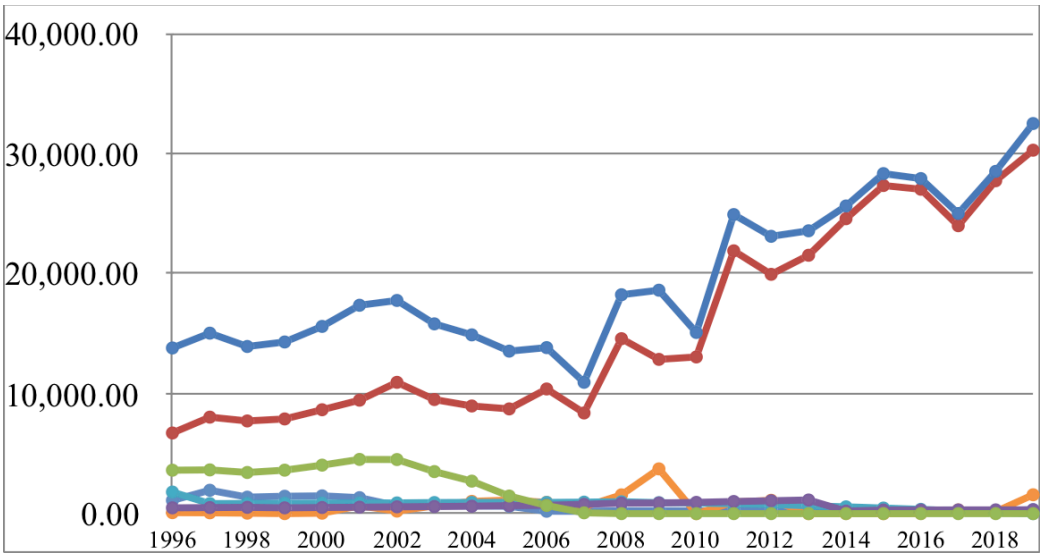

Figure 4.9: Chile’s central bank assets (blue: total, red: foreign exchange reserves, green: Fiscal Promissory Notes, purple: other public sector assets (CLP billions), light blue: subordinate debt, yellow: monetary policy derivatives, dark blue: others), source: Banco Central de Chile Statistics Database, Central Bank of Chile (CBCh) balance sheet, balances

From the 1980s until the mid-1990s, the competitiveness of Chile’s export sector was mentioned as core concern of Bank policymakers in the 1980s and 90s (Zahler, 1995a, 579; Massad, 1997b, 1184). Former Governor Zahler remarked that the Bank adopted a middle way between fixed and floating exchange rate regime as ”it was deemed convenient to give some guidance or signal to the market” for protecting the domestic export industry (Zahler, 2016, 36-37). While the stated objective of foreign exchange policy has shifted from export competitiveness to financial stability, it is difficult to disentangle them given that the prevention of currency appreciation not only helps dis-

August 2001	sale of up to USD 2 billion
October 2002	sale of up to USD 2 billion due to market overreaction
April 2008	purchase of USD 8 billion USD - this program was prematurely ended in September 2008 (with USD 5.75 billion purchased) given market volatilities following the Lehman Brothers failure
January 2011	purchase of USD 12 billion to accumulate reserves
November 2019	sale of USD 10 billion following market volatilities due to nationwide protests

Table 4.5: Chile's central bank foreign exchange interventions

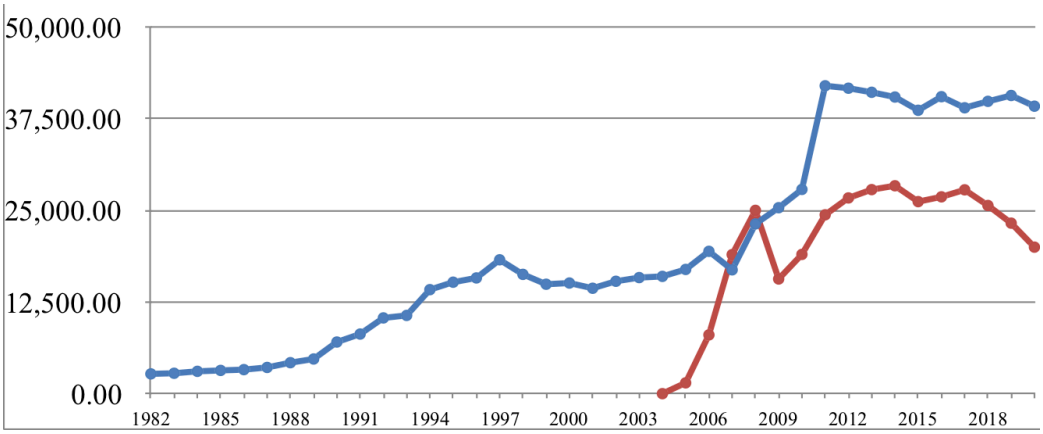

Figure 4.10: Chilean central bank reserves (blue) and government reserves (red) (USD million), source: Banco Central de Chile Statistics Database, Reserve assets by currencies, and Liquidity in foreign currency of CBCh and central government

courage the buildup of foreign debt but also supports the export industry by making exports cheaper for the rest of the world. As currency interventions were increasingly sanctioned by Western countries, particularly the U.S., this shift in the stated objective helped policymakers in non-Western countries like Chile or South Korea to circumvent this problem.

Beyond this, the state found other instruments to affect the exchange rate: Although the Bank did not intervene in the mid-2000s, it Figure 5.5 shows how the government intervened to counter rapid financial inflows in the run-up to the 2007 crisis. When the Bank reduced costs of its net foreign currency

position in the mid-2000s, the Treasury extended foreign currency holdings to the Bank to offset a negative effect on the overall reserves (Interview former Bank policymaker D, Santiago, 5 October 2018; BCC, 2007, 14-15). And as stated above, public financial institutions and institutional investors accumulated substantial amounts of foreign reserves.

Foreign exchange policy is thus used to safeguard financial stability. Similar to monetary and financial policy, the 1982 crisis was the watershed moment leading to a significant policy change that has shaped foreign exchange policy until today In an interview, one former policymaker stated:

> *we did have a very bad experience during the debt crisis of the early 1980s. We learned it the hard way that macro financial policy has to be well designed [...] and one of the main lessons of that crisis was that the current account matters, the external debt matters. So there was a huge concern about, you know, the current account, the exchange rate, because you didn't want to have a very appreciated exchange rate because that would produce a huge current account deficit etc.* (Interview former Bank policymaker A, Santiago, 10 October 2018)

4.5 Conclusion

This chapter aimed at showing how at three critical junctures (1973, 1982, 1990) government leaders exerted agency by appointing experts to key policy positions. In the first two instances, this agency was deployed to induce change, in the third instance to generate continuity. Furthermore, the chapter demonstrated how experience-based expert knowledge deployed by policymakers after the 1982 crisis resulted in divergence to Western standards. Policymakers adopted financial stability-oriented policies that tightly regulated the financial system, particularly international financial flows. This experience-based exert knowledge has thus served as resource of agency by Chilean policymakers to manage its liberalized financial system.

What do these findings imply in terms of complementing existing theories? Although structuralist explanations help to understand why specific expert knowledge was available at critical junctures, they only insufficiently explain why governments selected one over the other type of expert knowledge and the substance of adopted policies. The post-1982 turn by Pinochet and Aylwin's decision not to translate envisioned developmentalist policies

into practice in the early 1990s point to the role of agency that government leaders can deploy in critical junctures. Governments' appointments of experts such as the Chicago Boys in the 1970s, Hernán Büchi in the 1980s, and Alejandro Foxley in the early 1990s demonstrate how this political agency is translated into consequential policy change. Political motivations of government leaders were not so much derived from specific policy outcomes, but were based more on the need to fulfill other political objectives - be it the convenient supply of an alternative economic and social paradigm under Pinochet in 1973, an opportune possibility to induce policy reforms after the 1982 debt crisis, or the privileging of political and social stability over partisan politics by the *Concertación* in 1990.

All three choices were supported by interests, such as the private sector's resistance to Allende's policies in the early 1970s or when the democratic opposition envisioned a return to developmentalist policies in the late 1980s. Although Büchi put new regulations in place that restricted market actors, he also made sure to pacify foreign interests by committing to the full repayment of external debt, and domestic interests by intensifying the privatization of public companies. Nevertheless, these do not account for the possibility that governments could have made different choices and could have satisfied other existing interests. More than institutional and interest-based explanations, political motivations are key factors that contributed to policymaking in Chile after 1973.

Pinochet was not an ideological market-believer and appointing hardcore neoliberals to influential policy positions after 1973 was rather a convenient option on the table to induce policy change in a devastated country. When the tables turned in 1982, Pinochet faced the difficult challenge to make concessions to a dissatisfied public without affronting key support from the right wing and private sector. It was thus a strategic decision to replace the Chicago Boys with the hands-on approach of Büchi, who was well-respected in right-wing circles while at the same time offering a decisively different policy approach to recover from the crisis and implement new policies to enhance management of liberalized financial markets. His undogmatic policy change contributed to Chile's economic recovery in the 1980s.

Also Aylwin's decision to turn away from policies the opposition envisioned during the resistance against Pinochet to prevent a tense social and political situation from getting out of control point to the strategic considerations in the appointment of experts to key policymaking positions. While Aylwin induced significant change to social policy to satisfy the left elec-

torate, policies to manage financial liberalization remained neoliberal. It is, however, unlikely to assume that this policy continuity would have occurred when undogmatic policies from the 1980s were not successful in terms of recovering from the 1982 crisis and safeguarding financial stability. Based on this stability, Chile's governments were also in a better position to counter pressure from Western countries to discontinue their tight regulations, particularly on international financial flows in the 1990s.

The choice by Aylwin and the *Concertación* to adopt a compromise strategy gradually turned into a policy consensus over time. Today, there is a wide consensus among politicians and experts in Chile that emphasize the 1982 debt crisis as a historical juncture and critical turning point for the adjustment of monetary, financial, and foreign exchange policy. All interviewees emphasized that this moment has influenced expert knowledge until today. The policy consensus strengthened over time, materialized in a tight policy network of experts and politicians within which key positions were revolving. This consensus do not question the overall benefits of free markets, they do however use monetary, financial, and foreign exchange policies to tightly regulate financial institutions. Interviewees highlighted the coordination of different policies for safeguarding stability (former Bank policymaker A, Santiago, 10 October 2018). As one former minister put it: "there is a political general acceptance that a stable management of the economy without ups and downs is the main objective of any government" (Interview former Chilean minister A, Santiago, 13 October 2018).

This policy consensus also encompasses the private sector, thus lending it further acceptance from a possible veto player to the government. There is a significant overlap of interests and the policy network that reaches back to the Chicago Boys era in the 1970s (Teichman, 2001). As shown by Boylan (2001), private sector interests also contributed to the adoption of central bank independence in 1989 as a protection against left partisan politics. Many Chicago Boys themselves became heads of big conglomerates. Several members of the policy network have strong linkages to the private sector and have adopted different positions in the management or directorate of private companies, such as pension funds, including Büchi, Larraín, Corbo, Desormeaux, Vergara, and de Gregorio.

The interplay between ideas and institutions, on the other hand, reflect well how political agency has been used to induce policy stability. Pinochet was the head of a relatively powerful dictatorship (in comparison to Argentina's *Proceso*) and could thus effect institutional change without much

resistance. Compared to other countries on the continent, Chile stood out for sustaining strong support of institutional stability, that has been propelled by the policy network during and after the transition to democracy. Initially however, it was not sure that the *Concertación* will accept institutions established under Pinochet, such as the 1981 constitution, far-reaching amnesty for military officials or the Bank Act 1989. Even informal institutions have been honored after 1990, including the appointment of board members and governors of the Bank. That no presidents chose to disregard this informal rule of to make partisan appointments such as in Japan under Abe or Argentine since Menem, points to the strength of the policy consensus across the political spectrum.

Chapter 5

Argentina

This chapter analyzes the impact of the selection of expert knowledge on policy change in Argentina after 1976. Similar to Chile, the selection of experts to key policymaking positions has had a significant effect on the management of its financial system that was initially liberalized under a right-wing neoliberal dictatorship (1976-83), resulting in a financial crisis 1982. Policy change in Argentina, compared with the other cases, has been amplified by frequent and disruptive breaks between left- and right-wing governments. Governments have induced policy change to either weaken or strengthen control over the financial system. Lacking a policy consensus like the one forged by former Chilean President Aylwin in the early 1990s, changes of government induced a frequent replacement of experts. For informing policy change, governments drew on established types of expert knowledge: one developmentalist traditional to Latin America for left-wing governments, the other academic neoliberal knowledge promoted by Western countries for right-wing governments. Only under the brief government of Néstor Kirchner, an *outsider* (Martín Redrado) was appointed to inform policy change that went beyond these established types. The study of the Argentine case thus serves to demonstrate that there is no immutable logic to policy convergence and that political agency in shaping policies by using expert knowledge remains present.

Motivations of the president for the selection of key policymakers have been partly based on strategic considerations (Carlos Menem, 1989-99; Néstor Kirchner, 2003-8), partly based on either developmentalist (Cristina Fernández de Kirchner, 2008-15) or neoliberal (Mauricio Macri, 2015-19) ideologies to which presidents committed to. Close links between politicians and

experts formed policy networks that strongly affected policymaking under Fernández de Kirchner and Macri, who drew on well-established developmentalist respectively neoliberal policy networks. However, these structures cannot explain two instances where presidents appointed experts that did not come from the respective policy network: Firstly, when Peronist President Menem decided against continuing traditional developmentalist policies that had characterized Peronism and instead appointed Domingo Cavallo, an expert from the opposing neoliberal policy network, to become finance minister in 1991. Cavallo introduced the *Convertibilidad* policy experiment that shaped policymaking throughout the 1990s and resulted in 2001 in the largest sovereign debt default in history. Secondly, when Kirchner decided to adopt a consensus-driven approach to policymaking that aimed at overcoming political divisions between left and right. Having appointed Martín Redrado, who is neither part of the neoliberal nor developmentalist policy network, to head the Argentine central bank (2004-10), policies were introduced that strengthened regulation of the financial system (linked to left-wing governments) while curtailing developmentalist state interventions (linked to right-wing governments). These two instances give further evidence for political agency that can be deployed to shape policymaking by either appointing experts from opposing policy networks or *outsiders* that do not come from established policy networks.

Similar to Chile, expert knowledge was promoted via research institutions which were often founded or directed by key policymakers and that were linked with the president in power. These investments in the production of expert knowledge has served as a resource to produce political agency.

This chapter is structures as follows. After a concise historical overview of the developmentalist era in Argentina and the neoliberal turn under the military dictatorship (1976-83) (Section 5.1), the subsequent sections analyze four episodes where presidents appointed experts to key policymaking positions for inducing policy change: Menem's appointment of finance minister Cavallo who introduced his neoliberal *Convertibilidad* policy experiment in 1991 (Section 5.2); Kirchner's selection of central bank governor Redrado for the adoption of financial stability-oriented policies in 2004 (Section 5.3); Fernández de Kirchner's nomination of Mercedes Marcó del Pont to head the central bank and bring about a return of developmentalist policies in 2010 (Section 5.4); and Macri's appointment of Frederico Sturzenegger as central bank governor in 2015 to return to neoliberal policies (Section 5.5). Section 5.6 concludes.

5.1 Developmentalism and financial liberalization during the *Proceso*

Developmentalist expert knowledge that informed policymaking in Latin American countries, including Argentina, in the second half of the 20th century can be traced back to the Economic Commission for Latin America and the Caribbean (CEPAL), which was co-founded by the Argentine Raúl Prebisch (Sikkink, 1988, 2012). In the three decades following the end of World War II, monetary, financial, and foreign exchange policies were actively used by the state to propel economic development using the strategy of import-substituting industrialization. The financial system was under direct control of the state that determined the allocation of credit to targeted sectors in the economy. To establish this control over the financial system, President Juan Perón nationalized both the Argentine central bank, which was co-founded and directed by Prebisch (1935-43), and bank deposits in 1946 (Cavallo and Cavallo, 2017, 118-9).[1] But unlike for the cases of Japan and South Korea, state-led policies failed at inducing economic development. Instead, similar to Chile in this period, public investments were relatively unproductive, resulting in recurrent over-expenditure, inflation, and debt crises (see Rapoport (2010)). The country was further destabilized by frequent changes of government, violent conflicts between communist and fascist groups, interest politics by the United States in the context of the Cold War, and military coups in 1955, 1962, and 1966.

Following a *coup d'état* in 1976, a military junta around General Jorge Videla replaced the unstable government of Isabel Martínez de Perón[2] that was further weakened following a financial crisis (*Rodrigazo*) in the mid-1970s (Romero, 2002, 213-4). Videla established a dictatorship (*Proceso de Reorganización Nacional*) that, in search of experts to inform financial and economic policy change, recruited neoliberal experts that stood ready to translate their ideas into policies. Similar to the case of Chile, they were educated at ne-

[1] Perón's influence on the post-WW II political, financial and economic history in Argentina has been strong. Until today, *Peronism* is the most important political movement in Argentina that encompasses multiple parties from the developmentalist to neoliberal spectrum. Perón drew on nationalist and developmentalist ideas that were inspired by European fascism of the 1930s/40s (Huser, 2002, 34-5; Romero, 2002, 108; Loveman, 1997, 58).

[2] Martínez de Perón was the wife of Juan Perón who returned from exile in 1973 and replaced him when he died in the following year.

oliberal economy faculties in the U.S.. The cooperation of the University of Chicago and Catholic University of Chile since 1955 served as an example to establish a similar partnership program (*Programa Cuyo*) between University of Chicago and National University of Cuyo (Fernández, 2019, 1). However, unlike in Chile, the process of replacing developmentalist with neoliberal knowledge was not as thorough in Argentina, and important universities like the University of Buenos Aires did not fully subscribe to neoliberalism like Chilean universities did (see Undurraga (2015)). Nevertheless, Videla's appointment of Martínez de Hoz to become economy minister (1976-81) and Adolfo Diz to head the Argentine central bank (1976-81), both linked to the *Chicago School*, were pivotal for liberalizing the financial system (Romero, 2002; Calvo, 1986; Undurraga, 2015, 222-3).

Neoliberal expert knowledge was institutionalized in two major laws from 1977 that have shaped Argentina's management of its liberalized financial system until today. Firstly, deposits were denationalized, thus delegating the task of allocating credit from the central bank (Bank) to private financial institutions (Law 21,495). Secondly, the Law on Financial Institutions (Law 21,526) deregulated the financial system, established reserve requirements, and ended the compartmentalization of the financial system (thus there was no differentiation anymore between types of financial institutions and services they can provide). The Bank has been the designated regulator to enact this law and uses the Superintendence of Financial and Exchange Institutions for supervisory purposes.[3]

In 1979, a crawling peg (*tablita*) was introduced to limit the depreciation of the peso. This resulted in an implicit overvaluation of the currency which led to a buildup of cheap foreign debt while impairing the competitiveness of the domestic industry (see Calvo (1986)). Once the U.S. Federal Reserve was increasing the policy rate in the early 1980s (Volcker Shock), financial flows to Argentina and other Latin American countries stopped, the currency was devalued, and financial institutions could not finance their foreign debt anymore. Similar to Chile, the resulting financial crisis in 1982 was aimed to be overcome by transferring foreign debt from the private to the public sector.[4] But unlike their Chilean colleagues, Argentinian policymakers

[3]Capital markets are supervised by the National Securities Commission (CNV), which is linked to the finance ministry.

[4]While Bank governor Domingo Cavallo introduced exchange rate guarantees in 1982, his successor Julio García Del Solar transformed the guarantees into an actual nationalization of foreign debt in 1983 (Cavallo and Cavallo, 2017, 163).

were not successful in the resolution of the accumulated foreign debt and did not introduce new laws to adopt policies that prevent similar crises to occur in the future. Until today, the nationalized foreign debt remain in form of non-marketable securities a major position on the Bank's balance sheet.[5] While Chile used this nationalized debt to promote the development of domestic capital markets by providing investment possibilities for the growing institutional investors, Argentina's policymakers did not follow this strategy. Furthermore, Argentina's policymakers did not adopt significant changes to modify monetary, financial, and foreign exchange policies for protecting the country from a repetition of a similar crisis. The Bank Charter and the Financial Institutions Law were not changed to incorporate the crisis experience 1982.

One factor that amplified problems in the response to the crisis was the unstable political situation. While Chile's Pinochet could maintain his grip on power by inducing policy change, the comparatively weak Argentine military junta was not able to sustain its position after the 1982 crisis. Its demise was accelerated by a devastating military defeat against Great Britain in the Malvinas War the same year. Thus the transition to democracy did not occur under relative financial and economic stability but at the height of a financial and economic crisis. Under the presidency of Raúl Alfonsín (1983-1989), several short-lived policy experiments were conducted to resolve the crisis. In 1985, Finance Minister Sourouille introduced a new currency (*Austral*), and established price and wage controls to break the high inflation record (Romero, 2002, 270). Another attempt to break high inflation expectations was made in 1988 with the *Plano Primavera*. These reforms were however only of temporary help to stabilize the financial system and economy. Inflation spiked again and Argentina went into another debt default in 1988. Against this background of constant crisis, the Peronist Carlos Menem won the elections in 1989. While it was expected that he will purse state-led financial and economic policies traditionally linked to Peronism, Menem surprised many observers by implementing neoliberal policies.

[5] In combination with the debt accumulated in the 2001 crisis this amounts to ARS 3.4 trillion (USD 57 billion) by late 2019. The 1990 Argentine Treasury Consolidated Bond was issued to finance the government debt to deal with the fallout of the 1982 debt crisis. It is to be amortized in 90 annual installments over 99 years (later changed to 80 annual installments).

5.2 Cavallo's *Convertibilidad* experiment

Carlos Menem was elected in 1989 to succeed Alfonsín as president. Belonging to the Justicialist Party, Argentina's largest Peronist party, it was widely expected that Menem would maintain a strong state control over the economy and financial system. It was thus surprising to many observers that he instead initiated neoliberal reforms (see Strikes, 2001, 71-72; NYT, 1991a). Rather than being a committed neoliberal ideologist, Menem appointed neoliberals to key policymaking positions as a strategic decision to overcome opposition from within the Peronists and bolster his power position (Romero, 2002, 292, 298; Bambaci et al., 2002, 78).

Initial and unsuccessful attempts to stabilize the financial and economic system were conducted by economy ministers Miguel Ángel Roig (1989) and Néstor Mario Rapanelli (1989), both former managers of the Argentine transnational company Bunge & Born. After also Antonio Erman González (1989-91) failed to resolve the prolonged crisis, Menem decided in February 1991 to transfer the neoliberal Domingo Cavallo from his position as minister of foreign affairs to head the Ministry of Economy (see Cavallo and Cavallo (2017, 193-4)). For granting Cavallo the necessary power to implement his envisioned far-reaching policy changes, Menem gave him a super ministry by transferring the responsibility for trade, agriculture, industry, mining, energy, transportation, and communications to him.

Cavallo introduced a range of policies to reduce state interventions, including restrictions on fiscal expenditure, privatizations of public companies, trade liberalization, and the end of price controls. Going beyond the adoption of these typical neoliberal reforms, it was the combination of the *Convertibilidad*, a 1:1 peg of the peso to the U.S. dollar, and financial liberalization that characterized financial and economic policy in the 1990s. Introduced in April 1991, Cavallo's Convertibility Law strictly limited the use of monetary and foreign exchange policies to the objective of maintaining the dollar peg, while financial policy was to be used to liberalize and promote the development of the financial system. While this change initially generated the desired effects of lowering the inflation rate and increasing economic growth rates, the reliance on this policy mix inhibited the same financial risks as the Chilean peg-and-liberalize strategy of the late 1970s: implicit currency appreciation, buildup of foreign debt, weakened competitiveness, and sustained current account deficits (Figure 5.1). As policymakers became aware of this fragile situation when facing an economic slowdown in the late 1990s, it was difficult

to reverse it. Argentina was at the mercy of international organizations and global investors to roll over an constantly growing foreign debt. When the Bank was forced to unpeg the peso in January 2002, the relative foreign debt burden exploded, resulting in the largest sovereign debt default in history.

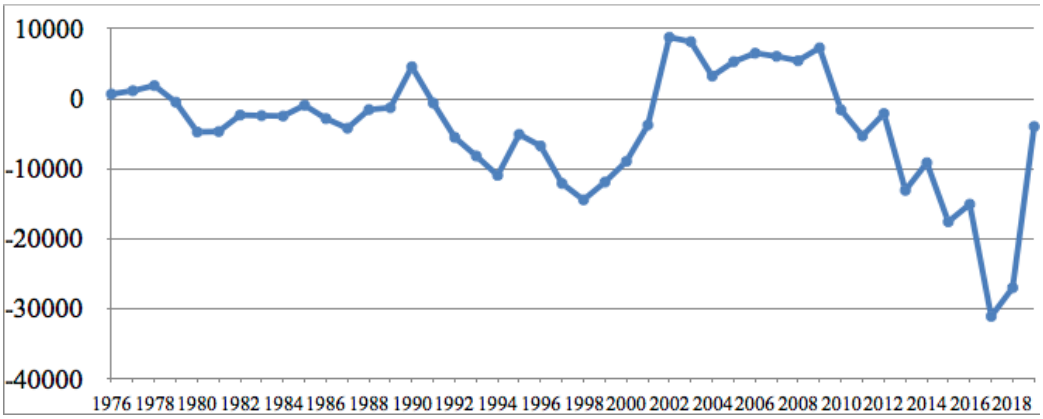

Figure 5.1: Current account of Argentina (USD million), source: IMF Database, Balance of Payments and International Investment Position Statistics (BOP/IIP)

What was the rationale behind this policy experiment that severely constrained policy options for policymaking by ending political control over monetary and foreign exchange policy? Cavallo's *Convertibilidad* promised to solve the problem of state inefficiency, which according to him was at the core of the recurrent financial crises of the 20th century, by tying the hands of politicians while empowering the private sector. Cavallo believed that if all government debt needs to be backed by U.S. dollar, liberalized financial markets will discipline state behavior and propel economic development by extending credit to profitable investments (Cavallo, 1997; Cavallo, 2004, 3; Cavallo, 1996, 176; Interview Argentinian economist, Buenos Aires, 20 September 2018). State interventions are to be limited to the establishment of "clear, simple and self-applying rules of the game" (Cavallo, 1991, 6). Not less than "a complete reorganization of the economy" was envisioned by him (Cavallo and Cavallo, 2017, 179).

To develop his policy agenda, Cavallo founded the research institution *Instituto de Estudios Económicos sobre la Realidad Argentina y Latinoamericana* (IEERAL) in 1977 after completing his PhD at Harvard University. In the 1980s, Cavallo published several books, including *Volver a Crecer* (Back

to Growth), *La Argentina que puede ser* (The Argentina that Could Be), and *Economía en Tiempos de Crisis* (Economy in Times of Crisis), to establish policy proposals that stand ready to be translated into policies once he was appointed to become super minister under Menem.

With Menem's appointment of the Chicago Boy Roque Fernández to head the Bank (1991-6), Cavallo could rely on a committed neoliberal partner. When the strategic partnership between Menem and Cavallo grew tense due to disagreements over policy reforms in the mid-1990s, the latter head to leave office in July 1996 and he subsequently founded his own party (*Action for the Republic*). As Fernández replaced Cavallo as minister of economy, policy continuity was nevertheless assured. Also the newly appointed Bank governor Pedro Pou (1996-2001) supported Cavallo's neoliberal policy agenda, praising the *Convertibilidad* for forcing Argentina to generate a "budgetary" or "fiscal culture" (Pou, 1998a; Pou, 1999d). Having jointly established the neoliberal research institute *Centro de Estudios Macroeconómicos de Argentina* (CEMA) in 1978, Fernández and Pou's were key figures in the rise of neoliberal expert knowledge in Argentina (see Fernández (2019)).

5.2.1 Monetary policy and foreign exchange policy

The use of monetary and financial policy to shape financial and economic conditions was given up during the *Convertibilidad*. With the 1:1 peg of the peso to the U.S. dollar, the only objective was to keep the exchange rate fixed, for which the Bank maintained at all times dollar reserves at least as high as the monetary base. Furthermore, changes to the Bank Charter were made with the enactment of Law 24,144 in September 1992. Independence from the government was established and price stability became the sole objective of the Bank, thus replacing the mandate for economic development.[6] Appointments to the Bank's policy board, which was previously filled with representatives of public financial institutions and the government, were now required to be experts in monetary, banking or legal issues in finance (Bank Charter, Art. 6).

While the new Charter indicated a bold turn away from the role of the Bank as financier of the government, the central bank was nevertheless con-

[6]Limits to independence were established in Article 12 (Bank Charter) that gives the Minister of the Economy the right to participate in the board meetings (without vote), and in Articles 20 and 33 that give the Bank the possibility to finance the public deficit of purchases at market price up to one third of freely available foreign exchange reserves.

tinued to be used to maintain massive amounts of non-marketable government debt from the 1982 crisis on its balance sheet. The creation of the 1990 National Treasury Consolidated Bond in February 1991 further consolidated government debt with the Bank. While the Bank was thus used to help finance existing public debt, the objective of preventing the adoption of more public debt was strictly adhered to in the 1990s.

5.2.2 Financial policy

Financial liberalization was fully embraced during Cavallo's *Convertibilidad*. Cavallo's main idea was that the liberalization of the financial system will establish market discipline that in turn was expected to generate economic and financial stability while constraining public expenditure. In 1989, Menem introduced the State Reform Law and the Economic Emergency Law which discontinued developmentalist policies, restricted public financing, and promoted equal treatment of foreign capital for productive investments. Deposit insurance was removed and liquidity provision by the Bank was discontinued. In January 1994, financial inflows were further propelled with the privatization of public banks and the establishment of equal treatment of domestic and foreign financial institutions as well as of banks and non-banks.

Financial regulations There was an adoption of relatively tight financial regulations to accompany the liberalization process. The 1992 adjustment of the Bank Charter put the regulatory focus on the microprudential level. Capital adequacy ratios, credit risk ratios, loan classifications and provisions as well as limits to financial interconnections were introduced, and high reserve requirements were maintained (BCRA, 1995). From a regulatory perspective, the financial system was sufficiently capitalized and liquidity requirements were in place.

Instead of aiming to increase independence from foreign finance as Chile did after 1982, Governor Pou emphasized that the inflow of global finance is needed to propel both economic growth and the development domestic capital markets (Pou, 1998b). Measures to control inflows such as Chile's capital controls of the 1990s were denounced as these would prevent the "disciplining effect" of global financial flows (Pou, 1999c). From the Bank's perspective, the constant current account deficit (Figure 5.1) was not seen as source of risk, like for policymakers in Chile, but instead as having a positive effect on economic development:

> *The current account deficit is the result of an investment rate higher than our domestic savings rate [...] These investments will improve the country's competitiveness and will be a source for increasing exports, which will lead to a balanced current account balance* (Pou, 1998b)

Also Cavallo did not account for the risks attached to an appreciated currency. He instead denounced the use of foreign exchange policy, declaring that it was an "illusion" to think that competitiveness can be increased via "monetary tricks" (Cavallo, 1997).

Public financial institutions and institutional investors Another key aspect of financial policy in the 1990s was the dismantling of public financial institutions - particularly public banks which were important funding sources for public expenditure during the developmentalist era (see D'Amato and Molinari (1998)). In 1992, the public development bank *Banco Nacional de Desarrollo* was liquidated and absorbed by the public *Banco Nación*, which in turned played a central role in the developmentalist era but was heavily downsized in the 1990s, alongside failed attempts to privatize it. By 1998, most public banks were privatized. To offset some of the negative effects of development financing, the Bank for Investment and Foreign Trade (BICE) was founded in 1992 for the support of export financing.

The pension reform of Chile in 1981 served as blueprint for the establishment of the Integrated Retirement and Pension System in 1993. But in contrast to Chile, Argentinian pension funds' investments remained with around 50 percent of their assets heavily invested in public securities (see Rofman (2000, Statistical Appendix Table VII)). Half of this public securities were non-marketable, thus they are committed to hold until redemption (Vittas, 1997, 22,23). Unlike their peers in the other three cases, Argentine policymakers drew on financial resources from public financial institutions and institutional investors to finance public debt instead of using it for anticyclical stabilization of the financial and economic system or the promotion of the development of domestic capital markets.

Policymakers induced incremental policy change after the 1995 Tequila crisis caused market volatilities and indicated to the fragility of the *Convertibilidad*. The supervisory framework was improved, regulation of maturity and currency mismatches was tightened, capital requirements were increased, and a deposit insurance scheme (SEDESA) was introduced. The Financial

Institutions Law was adjusted to increase the capacity for liquidity provision and restructure distressed institutions. Furthermore, the crisis was used to propel the process of privatization of provincial banks. Trust funds were established in cooperation with World Bank and Inter-American Development Bank to manage bad assets of commercial and public banks (BCRA, 1999, 150). Following the crisis, the number of banks decreased from 205 to 166 by mergers and acquisitions, 9 went bankrupt (Rozenwurcel and Bleger, 1998).

Monetary policy remained constrained to support the dollar peg. However, the Bank's use liquidity policies was partly reinstated, including by the introduction of liquidity operations with repurchase agreements, establishment of a liquidity network with 14 international banks, lowering reserve requirements, and interventions in the foreign exchange market. This policy adjustment was institutionalized in the Bank Charter, which allowed for more space for rediscounts and advances during systemic crises (Art. 17).

Following the crisis, Argentina policymakers grew increasingly wary of the potential impact of international financial flows on financial stability, particularly when the U.S. Federal Reserve increases its policy rate like it did in 1994 (Pou, 1998e,f,c,d). Given the reduced access to global finance in the late 1990s, policymakers saw themselves in a position of dependence towards advanced economies, particularly the United States, and international organizations like the IMF. Policymakers repeatedly asked them to strengthen global liquidity provision for preventing financial crises that are due to a temporary lack of access to financial markets. But calls to IMF, Basel Committee, and G7 for the establishment of such a mechanism brought no results (Pou, 1998c,f, 1999a,b). In 1999, Pou foreshadows the coming crisis given this shortcoming of global financial governance:

> *I have argued that liquidity risk is crucial and that in Argentina we have developed a strong liquidity policy, as well as strong economic fundamentals more generally, unfortunately I am forced to conclude, after recent events, that this may not be sufficient* (Pou, 1999e)

Despite of the growing awareness of the deficiencies of the *Convertibilidad*, policymakers refused to give up the peg until the last moment possible. This did also not change after President Menem, who was not allowed to run for a third term, was replaced by Fernando de la Rúa from the Radical Party in 1999. Having missed the possibility to accumulate sufficient foreign exchange reserves in the boom period and lacking tools to manage

exchange rate movements, policymakers lacked policy instruments necessary to reduce the likelihood that international financial flows result in a foreign debt crisis. The crisis grew closer when the economic situation and current account deficit deteriorated in the late 1990s. Public and private sectors, which have increasingly financed themselves via international financial markets (Figures 5.2 and 5.3), found it increasingly difficult to roll over growing foreign debt. In March 2000, financial support by international organization was requested. Debt swaps in 2000 and 2001 could not solve liquidity shortage, and access to global liquidity remained severed. Stabilization efforts failed and in late 2001 Cavallo, who briefly returned to become economy minister, declared a sovereign debt default and froze bank accounts (*Corralito*). The crisis reached its peak with the killing of dozens of citizens in violent protests throughout the country in December 2001. With Eduardo Duhalde, Argentina's fourth president within two weeks, enacting the Law of Economic Emergency in January 2002, the dollar peg was discontinued, a floating exchange rate reinserted, and domestic control over monetary, financial, and exchange rate policy reinstated.

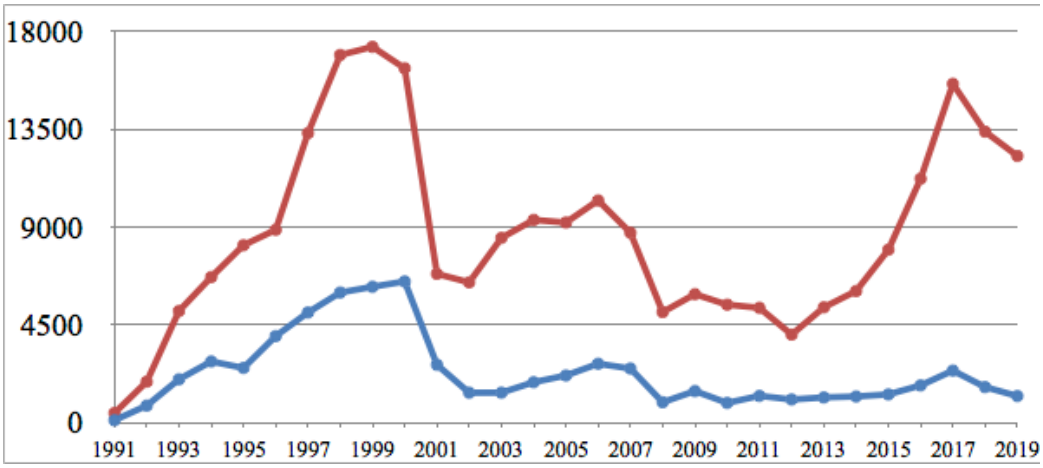

Figure 5.2: Foreign debt securities on liability side of financial institutions (blue) and non-financial institutions (red) of Argentina (USD million), source: IMF Database, Balance of Payments and International Investment Position Statistics (BOP/IIP)

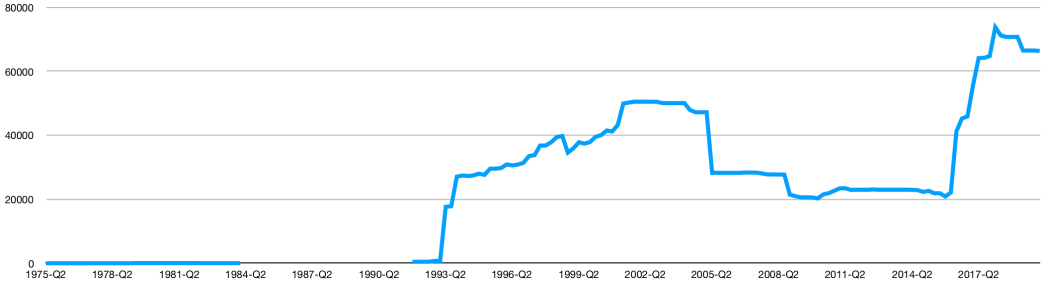

Figure 5.3: Argentina's international debt securities, total amount outstanding, general government (USD million), source: BIS Debt Securities Statistics

5.3 Néstor Kirchner: forging compromise

Néstor Kirchner won the election in May 2003 against Menem to become the 5th president within 4 years. His presidency (2003-8) coincided with a brief period of recovery and stability.[7] Although he was like Menem member of the Justicialist Party and largely supported the *Convertibilidad* during his tenure as governor of Santa Cruz (1991-2003), both differed in their policy approach to manage Argentina's liberalized financial system. On the one hand Kirchner changed social policies significantly to reduce growing poverty from the 1990s. But on the other he did not revert to developmentalist policies, instead pursuing a third way that went beyond the split policy approaches of right and left-wing governments. Following the crisis experience of 2001, monetary and foreign exchange policies were changed to increase control over international financial flows and safeguard the stability of the domestic financial system.

The choice of experts to inform this policy change was distinctive, as Kirchner did not resort to well established categories of expert knowledge in Argentina. Instead an outsider, Martín Redrado, was appointed to head the Bank who reflected Kirchner's compromise approach. By *not* drawing on established neoliberal or developmentalist expert knowledge prevalent in Argentina's universities and research institutions, Kirchner exerted agency in shaping policy change. The pick of Martín Redrado in September 2004

[7]The relatively successful presidency of Kirchner benefitted from favorable external conditions, including an increase in global liquidity and higher commodity prices. See Weisbrot et al. (2011) for a discussion of the view that the commodity price boom caused economic recovery in Argentina.

to replace Alfonso Prat-Gay as the head of the Bank, after disagreements over the strategy of debt repayment to the IMF led to his dismissal, reflects his compromise approach (Clarin, 2004). Redrado partly continued policies introduced under Prat-Gay, a neoliberal and later economy minister under President Macri who was appointed by Kirchner's predecessor Eduardo Duhalde (Justicialist Party), and partly introduced new changes to monetary, financial, and foreign exchange policy. With 6 years uninterrupted in office, Redrado held this office the longest in the history of the central bank, following only the Bank's first governor Ernesto Bosch (10 years) (see Table 5.1).

Previous to his appointment, Redrado held public positions as secretary of International Economic Relations[8] (2002-04) and as director of the National Securities Commission (1991-94). Redrado was an unusual pick to this key policy position given that he neither belonged to any of the existing camps of expert knowledge nor pursued an academic career. Instead, his background is based on practical experience in financial regulation and as investment banker. Redrado did not receive a PhD but earned a diploma in economics from University of Buenos Aires and a graduate degree in Public Administration from Harvard University. Although having written several unacademic books, he did not publish academic papers in peer-reviewed journals. Redrado is founder of *Fundación Capital*, a research institution he used to provide policy analyses and recommendations after he was dismissed from the CNV in 1994.[9]

Breaking with the rigid policies of the *Convertibilidad*, Redrado embraced "flexibility and gradualism" in the design and implementation of policies in the pursuit of safeguarding financial stability (Redrado, 2010, 111). He criticized, similar to Chile's Büchi, overly academic approaches to policymaking (such as those underpinning the *Convertibilidad*), stating that "economic theory is having a hard time keeping up with praxis" (Redrado, 2009a, 2) and that "[w]e have reached a point in which economic theory is having a hard

[8]During his time as secretary, he cited South Korea and Chile as role models of economic development, emphasizing the need of a strong state for coordinating monetary, financial, and foreign exchange policies (Redrado and Lacunza, 2004, 9,12). He also highlighted the benefits of Chile's regulation of short-term capital flows following the 1982 debt crisis (ibid.).

[9]Redrado was fired by Menem over his open criticism of Cavallo's privatization of YPF which he considered favored the managers of the sale, First Boston and Merrill Lynch, at the cost of Argentine's taxpayers (NYT, 1994).

Governor	Academia	Work
Javier González Fraga 1989	Professor at Catholic University Argentina; Economics degree, Catholic University Argentina	Director of public companies; vice president of stock exchange in Buenos Aires; Director of Instituto Argentino de Mercado de Capitales; agriculture entrepreneur
Egidio Iannella 1989	Professor at University of Buenos Aires, Catholic University Argentina, Argentine University of Enterprise	Founder and director of VISA Argentina; president National Development Bank; president National Savings and Insurance Fund; vice president Argentine Federal Bank; director Federal Investment Bank
Rodolfo Rossi 1989-90	PhD in Economics, University of Buenos Aires	Director Liquid Carbonic Corp.
Enrique Folcini 1990	Professor at University of Buenos Aires, Catholic University Argentina; undergraduate degree political economy, University of Buenos Aires	Undersecretary of the Economy and Labor, Secretary of the Treasury
Antonio Erman González 1990	Degree in accounting	Ministry of Economy, Health, Labor, and Defense; parliamentarian; president of Bank of La Rioja;
Javier González Fraga 1990-1	see above	
Roque Fernández 1991-6	Professor University of Southern California, University of Chile, Catholic University Chile; Economics degree and PhD, National University of Córdoba; Economics PhD, University of Chicago; National University Córdoba; numerous publications	Minister of Economy and Public Works and Services; World Bank; IMF; United Nations; Instituto de Matemática y Estadística; Economy Minister of Córdoba
Pedro Pou 1996-2001	Finance degree, University of Chicago	Founder and director of Center for Macroeconomic Studies (CEMA); Minister of Economy in Buenos Aires; agriculture entrepreneur
Roque Maccarone 2001-2	?	Vice president Río de la Plata Bank; president of Association of Argentine Banks; Secretary of Finance, Banks and Insurance; president Banco Nación; advisor Banco Galicia
Mario Blejer 2002	Professor at PhD in New York University, Boston University, Hebrew University of Jerusalem; PhD economics, University of Chicago; undergraduate and graduate degrees economics, Hebrew University; numerous publications	IMF; World Bank; CEMLA
Aldo Pignanelli 2002	Economics degree, University of Bueons Aires	Director Banco de la Provincia de Buenos Aires; Undersecretary of Municipal Affairs, Buenos Aires; advisor to Banco de la Province of Formosa; Inter-American Development Bank; Secretary of the Economy, Moreno; various positions in private sector
Alfonso Prat-Gay 2002-4	Professor Catholic University Argentina; Economics graduate degree , University of Pennsylvania; undergraduate degree Catholic University Argentina	Co-founder APL Economía; JPMorgan; JPMorgan Chase
Martín Redrado 2004-10	Professor, Catholic University Argentina, Tres de Febrero University; Administration graduate degree, Harvard University; Economic undergraduate, University of Buenos Aires	World bank; WTO; BIS; Secretary of Commerce and International Economic Relations; president National Securities Commission; IOSCO; founder Fundación Capital; Security Pacific Bank; Salomon Brothers Inc
Mercedes Marcó del Pont 2010-3	Economics degree, University of Buenos Aires; Development economics graduate degree, Yale University	Parliamentarian; president Banco Nación; director Fundaciòn de Investigaciones para el Desarrollo; Instituto de Desarrollo Econòmico; Consejo Latinoamericano de Ciencias Sociales; Consejo de Investigaciones Cientificas y Tècnicas
Juan Carlos Fábrega 2013-4	?	President Banco Nación; Director of Visa Argentina; Chilean Banking Association; Chilean-Argentine Chamber of Commerce
Alejandro Vanoli 2014-5	Professor, University of Buenos Aires; Economics undergraduate, University of Buenos Aires; several publications	Central bank staff; Ministry of Finance; Advisor to Ministry of Economy, National Securities Commission;
Federico Sturzenegger 2015-8	Professor, UCLA; dean Escuela de Negocios de Di Tella; Economics PhD, MIT, degree National University La Plata; numerous publications	parliamentarian; YPF; secretary of political economy of Argentina; president Banco Ciudad de Buenos Aires; IBD, IMF, World Bank, United Nations, BIS
Luis Caputo 2018	Economics degree, University of Buenos Aires	Secretary of Finance; JP Morgan; Deutsche Bank,
Guido Sandleris 2018-9	Professor, Johns Hopkins University; dean Torcuato di Tella University; Economics PhD, Columbia University; graduate degree LSE; undergraduate University of Buenos Aires; numerous publications	Secretary of Economic Policy; Undersecretary of Finance, Buenos Aires; World Bank, IBD
Miguel Ángel Pesce since 2019	Economics undergraduate, University of Buenos Aires	President of Banco de la Provincia de Tierra del Fuego; YPF; chair Trust Fund for Reconstruction of Companies; Ministry of Economy; Trustee for the Nation; Secretary of the Treasury and Finance; advisor to the parliament

Table 5.1: Background of Argentina's central bank governors since 1989

time keeping up with praxis" (Redrado, 2009b, 4). Based on the experience of past financial crises, he called for a tightening of control over international financial flows and the exchange rate, as particularly countries with less developed capital and financial markets like Argentina were exposed to market volatilities (Redrado, 2009b, 2).

By focussing on the risks attached to financial liberalization *and* state expenditure, his policy approach contrasts with established expert knowledge in Argentina's developmentalist and neoliberal policy networks that focus on the benefits of either states or markets. Redrado's term in office was characterized by the adoption of new policies that can be put under the term neo-developmentalism, pursuing a third way between neoliberal and developmentalist policies (Bresser-Pereira, 2011; Gezmis, 2017). Policies aimed at curtailing risks to financial stability from both sides: markets and state. On the one hand, policymakers saw the necessity to implement a new policy mix entailing the management of the exchange rate, accumulation of foreign exchange reserves, and countercyclical, liquidity-focussed monetary policy for protecting the country against volatile international financial flows. On the other hand, also state expenditure was curtailed by the introduction of the Fiscal Responsibility Law in August 2004 and the adoption of exposure limits of financial institutions to public debt. Policy change under Kirchner and Redrado could build on favorable external conditions to stabilize Argentina's financial and economic system, and thus contributed to generating for the first time in more than 30 years a sustained current account surplus (Figure 5.1). Similar to Chile, policies aimed at curtailing risks of international financial flows and public indebtedness, which helped both countries to weather the 2007 financial crisis without experiencing heavy market volatilities.

Redrado's policy approach is also reflected in his stance to the question of global financial governance. Given their role as main drivers of international financial flows, Redrado called advanced economies for closer coordination to prevent international financial crises (Redrado, 2009b, 5; Redrado, 2009c, 3-4). In contrast to his predecessors, he also emphasized the need for reducing dependence on global finance by promoting the development of local financial markets (Redrado, 2009b,c, 2007). In combination with the management of the exchange rate, improved liquidity provision in the financial system, countercyclical monetary policy, and a tight regulatory and supervisory framework, Redrado aimed at establishing a policy mix to limit risk of financial crises (Redrado, 2012; see also BCRA, 2007, 3; BCRA, 2009, 3). Given his background as investment banker, he could draw on positive repu-

tation within the "international financial community" that made resistance to the new policies it less likely (see Redrado (2010, 170)).

The new policy approach was successful to the extent that it helped to prevent a new rise of financial volatilities. A case in point is Argentina's overcoming of the 2007 crisis: It is unlikely to assume that without the newly adopted policies to control international financial flows and curtailing of public indebtedness, there would not have been a renewed appreciation of the peso, an increase in cheap foreign debt, and new current account deficits as it frequently occurred in previous decades. Instead, when the 2007 crisis hit Western advanced economies and panicked global investors escaped from less developed countries in the 2007 crisis, Argentina weathered the crisis similarly well as Chile did. Peso appreciation and increase in foreign debt were countered and the stability of Argentina's financial system was perceived as indicator for this policy success (see Redrado (2010, 125)).

5.3.1 Monetary policy

Change of monetary policy under Redrado was focussed on managing liquidity conditions and shaping economic conditions by setting the policy rate - both tasks that were largely lost during the *Convertibilidad* and were only reinstated by President Duhalde in February 2002. Central bank securities (LEBAC and NOBAC) were issued as policy instruments. Furthermore, restrictions were loosened that forbid transfers from the central bank to the government. In September 2003, a new law by Kirchner expanded the capacity of the Bank to make advances to the government of up to 12 percent of the monetary base (in addition to the previous 10 percent of cash reserves).

A further objective to Kirchner and Redrado was to reduce the influence of the IMF in domestic policymaking, for which debt repayment to public and private creditors was necessary (Redrado, 2010, 63). A major step was the conduct of debt swaps in January 2005 with an acceptance rate of 75 percentage - the remaining 25 percent were mainly vulture funds that bought defaulted debt after the 2001 crisis and insisted on the full repayment. In December 2005, Kirchner issued a decree by which freely available reserves (international reserves in excess of stock required to fully back monetary base at existing exchange rate) became eligible to be used to pay back its debt to the IMF, which was completed the same year. A non-transferable security with a maturity of ten years was transferred from the government to the Bank to finance the debt repayment.

A test for the liquidity-focussed monetary policy was the 2007 financial crisis, which was overcome without severe repercussions on the financial and economic system. Facing periodic liquidity shortages during the 2007 crisis, foreign exchange interventions were combined with the provision of domestic and foreign liquidity. Open market operations were expanded, government securities and bank loans were accepted as collateral, and minimum reserve requirements in foreign currency were lowered. Additionally, swap lines to the central banks in China and Brazil were introduced in April 2009.[10] Furthermore, it was determined that LEBAC and NOBAC can only be traded on domestic markets by domestic entities, thus limiting the risk for domestic market volatilities due to speculative flows by global investors.

5.3.2 Financial policy

Financial regulation was updated after the 2001 crisis with a focus on two central aspects. Firstly, it was determined that lending in foreign currency was possible only when it is covered by income in the same foreign currency, and further capital requirements were imposed on currency mismatches. This change was due to the experience that two thirds of bank loans to the private sector were extended to debtors not active in the export sector, materializing in a massive currency mismatch once the *Convertibilidad* ended (BCRA, 2008, 32). In combination with new regulations on lending in foreign currency (2002) and adjustments to the foreign currency net global position (2003), risks attached to international financial flows were further reduced. When Argentina faced increased financial inflows in the mid-2000s (see Figure 5.1), unremunerated reserve requirements for financial inflows (30 percent) were established as an additional measure in June 2005.

Secondly, restrictions to lending to the public sector were implemented in April 2003, including minimum capital requirements of government jurisdictions and limits to the share of public sector securities to total assets. In 2006, the Bank introduced a 40 percent limit on bank exposure to public sector risk, which was lowered to 35 percent in July 2007 (BCRA, 2006, 48). Figure 5.4 shows how lending to the public sector was reduced during Kirchner's presidency.

[10] The swap line with the Chinese central bank was renewed in 2014, amended in 2015 and again renewed in 2017.

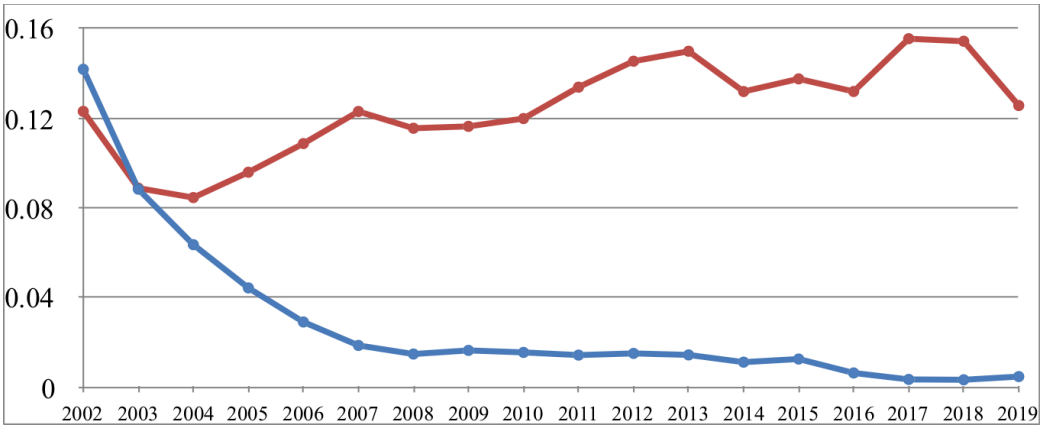

Figure 5.4: Lending to public sector (blue) and private sector (red) in Argentina (to GDP), source: Banco Central de la República Argentina, Situación Patrimonial; World Bank Development Indicators, nominal GDP

5.3.3 Foreign exchange policy

Foreign exchange policy returned like monetary policy to the hands of domestic policymakers with the end of the *Convertibilidad*. Redrado implemented a dual strategy for containing risks related to international financial flows: Firstly, the Bank countered appreciation pressure to promote growth in the export sector pursuing a "stable and competitive exchange rate regime" (Damill et al., 2015). Secondly, foreign exchange interventions helped prevent the buildup of financial risks by maintaining a low exchange rate that increased the cost of accumulating foreign debt. The resulting buildup of foreign exchange reserves (see Figure 5.5) was used as a self-insurance mechanism that the Bank considered to be necessary in light of the lack of a global liquidity provider (BCRA, 2007, 11-2).

5.4 Fernández de Kirchner's reversal to developmentalist policies

Cristina Fernández de Kirchner was elected to become president in December 2007, replacing her husband who did not run for office again. She was re-elected in October 2011 by the widest margin since Alfonsín's election in 1983, staying in office until Mauricio Macri won the presidential election

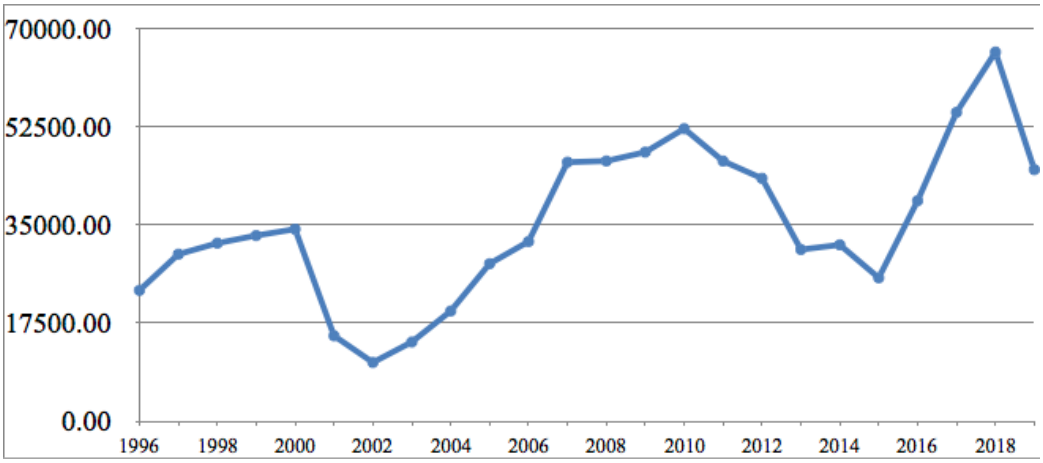

Figure 5.5: Foreign exchange reserves of Argentina's central bank (blue) (USD million), source: Banco Central de la República Argentina, Reservas Internacionales del Bank (en millones de dólares - cifras provisorias sujetas a cambio de valuación)

in December 2015. Fernández de Kirchner did not shun conflicts with political opponents both domestically and internationally, breaking with her husband's consensus-oriented policy approach. New policies put more emphasis on state interventions, linking back to developmentalist policies of the post-World War II era. This policy reversal is mirrored by the appointment of key policymakers, such as Mercedes Marcó del Pont to head the Bank (2010-3) and Axel Kicillof to become finance minister (2013-5), who both have a background in the developmentalist policy network. Political backlash to policies that were rejected by powerful interest groups frequently occurred, such as widespread protests by the agrarian sector against an increase of export taxes on grains (2008); the nationalization of private pension funds (2008); the ousting of Martín Redrado over the use of foreign exchange reserves (2010); the re-nationalization of YPF (2012); and the adoption of a new central bank charter (2013).

Policymaking under Fernández de Kirchner strengthened social policies and put more emphasis on state interventions in the financial and economic system. A range of monetary, financial, and foreign exchange policies were introduced to promote productive investments, encourage private and public spending, and limit financial speculation, including the use of credit policies, tighter financial regulation, capital controls, public funds, state expenditures,

and subsidies for targeted sectors. These policies followed well-established ideas of import substituting industrialization, entailing the protection of domestic industry against international competition and export taxes, which is mirrored in her 2020 Strategic Industrial Plan from March 2011 that affirmed the commitment to protect the domestic market and promote exports in preselected economic sectors. In addition to the developmentalist expert knowledge, Keynesian ideas about demand-led growth were adopted that presume that increased demand will lead to higher investments (see Marcó del Pont (2011, 43)).

In contrast to Kirchner, Fernández de Kirchner was eager to appoint experts from the established developmentalist camp in Argentina. Among those, the *Grupo Fénix* stands out which was founded in the early 2000s at the University of Buenos Aires to develop and promote alternatives to Menem's neoliberal policies (see Vanoli (2019)).[11] While Redrado initially continued to be Bank governor when she took over the presidency, Fernández de Kirchner decided to oust him in December 2009 when he refused, after a tense back and forth, to transfer the central bank's foreign exchange reserves for the payment of debt held by private investors (see WSJ (2010)). Redrado in his memoirs lamented that the central bank "became the victim of [the government's] abusive and improvised attitudes" (Redrado, 2010, 10). In February 2010, Redrado was replaced by Mercedes Marcó del Pont, who received a graduate degree in Development Economics from Yale University, was a founding member of *Grupo Fénix*, director of developmentalist Development Research Foundation (FIDE) since 1991 as well as a former member of several research institutions (Institute of Economic and Social Development (IDES), Latin American Council of Social Sciences (CLACSO), National Scientific and Technical Research Council (CONICET)). Fernández de Kirchner appointed Marcó del Pont first to head the *Banco Nacional* (2008-10), where she implemented new credit policies (Nación, 2008).[12] She was

[11] Among the group members was also Alejandro Vanoli, her successor as Bank governor (October 2014 to December 2015). Vanoli was also president of CNV before taking this position. In December 2019, he was appointed by President Alberto Fernández to head the National Social Security Administration. Further members of the group were Eduardo Hecker (president of *Banco Nación* since December 2019; President of CNV 2006 - 2009), Arturo O'Connell (worked at Bank from 1959-2015 in various positions), Aldo Ferrer. and Julio Olivera.

[12] Following her at the *Banco Nación* was Juan Carlos Fabrega (2010-13), who was also succeeding del Pont as governor at the Bank.

also congress-woman in the *Cámara de Diputados* between 2005 and 2008, where she already proposed a reform of the new Bank Charter to strengthen coordination with the government (see Cámara (2007)). When she was appointed to head the Bank, Marcó del Pont could translate her initial proposal into the central bank charter that was enacted in 2012. She was in office until November 2013, when Fernández de Kirchner reshuffled her Cabinet in a move to strengthen the Keynesian wing of finance minister Kiciloff[13] against the more inflation-averse wing of Marcó del Pont (Mundo, 2013; País, 2013).

The return of developmentalist policies is reflected in Marcó del Pont's new central bank charter that has linked the Bank's objective back to the time before the neoliberal change in 1976 (BCRA, 2013, 18). Article 3 of the 2012 Charter states that beyond price stability also "financial stability, employment, and economic development with social equality" are the Bank's objective. Marcó del Pont thought that this change is necessary to promote economic development in Argentina as also advanced economies followed the same interventionist central bank policies for promoting their economic development in the past (BCRA, 2012b, see also Marcó del Pont, 2010, 2).

Fernández de Kirchner and Marcó del Pont saw themselves in a battle against neoliberal economists that legitimized this unequal treatment of less advanced economies by refering to imaginary "'natural' and immutable laws of the market" that politicians cannot alter (Marcó del Pont, 2011, 45). In contrast to Redrado and Kirchner, Fernández de Kirchner and Marcó del Pont took a more decisive step against developed countries like the United States that use their power stance to promote their own interest in an unequal global financial system instead of providing less developed countries with guidelines based on how they achieved economic development (Marcó del Pont, 2010, 1-2). Particularly international financial flows reproduce dependence of less economically advanced countries that benefit advanced economies according to their persective (Marcó del Pont, 2018, 39,40). Referring to Raúl Prebisch's approach to the management of international financial flows, state interventions were considered to be necessary to prevent financial instability and promote economic development (Marcó del Pont, 2010, 1).

[13] Axel Kicillof, Fernández de Kirchner's secretary of economy (2011-3) and finance minister (2013-5), was a firm Keynsian-Marxian academic and professor at several Argentine universities, and contributed to the developmentalist policy change. Kiciloff was also central to the renationalization of YPF in 2012, and in tensions around U.S.' judge Griesa's questionable ruling in 2014 that Argentina needs to fully pay back vulture funds.

When the economy slowed down in the early 2010s, old problems like high inflation rates, volatile financial flows, exchange rate volatilities, and current account deficits reappeared which were initially countered by capital controls that were adopted in November 2011. However, this further propelled capital flight and the emergence of black markets. In this dire situation, U.S. judge Thomas P. Griesa's questionable ruling in 2014 to force Argentina pay at full all bond holders, even those that agreed to previous debt restructuring, and the subsequent debt default by Argentina further destabilized the financial and economic system, and strained relations between Fernández de Kirchner and global investors.

5.4.1 Monetary policy

The objective of monetary policy shifted, compared to Kirchner's presidency, more actively shaping credit allocation to targeted sectors in the economy and using the Bank's foreign exchange reserves to finance the government and conduct debt payments to private creditors. Firstly, credit policy was reintroduced for the first time since the 1980s, established in Articles 4 b) and 17 f) of the 2012 Charter, with the stated objective to channel financial flows to productive investments (BCRA, 2013, 19). A new credit facility (Credit Line for Productive Investments) ordered the 20 largest banks to allocate 5 percent of their loan portfolio to productive companies, 50 percent of which needs to flow to SMEs (July 2012). Furthermore, a reduction of reserve requirements was introduced for banks that allocate more than 30 percent of their loan portfolio to SMEs (December 2012). These instruments complemented the Bicentennial Productive Financing Program (PFPB) from October 2010 that was established for extending long-term financing via commercial banks to selected development projects (see BCRA (2011, 41)).

Secondly, monetary policy was used to smooth government financing (Article 20 of the new Charter) and finance debt payments to private creditors. Temporary advances to the government, the transfer of foreign exchange reserves from the central bank to the government, and that of non-marketable public debt securities the other way around became tools to enhance the financing of the government (see Figure 5.6). In November 2008, an adjustment to the Bank Charter allowed for the use of temporary advances for the payment of foreign debt. In December 2009, it was allowed to use foreign exchange reserves to cancel not only public but also private debt, which ultimately resulted in Redrado's dismissal in early 2010. Between 2010 and

2015, non-marketable securities were continuously issued by the government and transferred to the Bank.

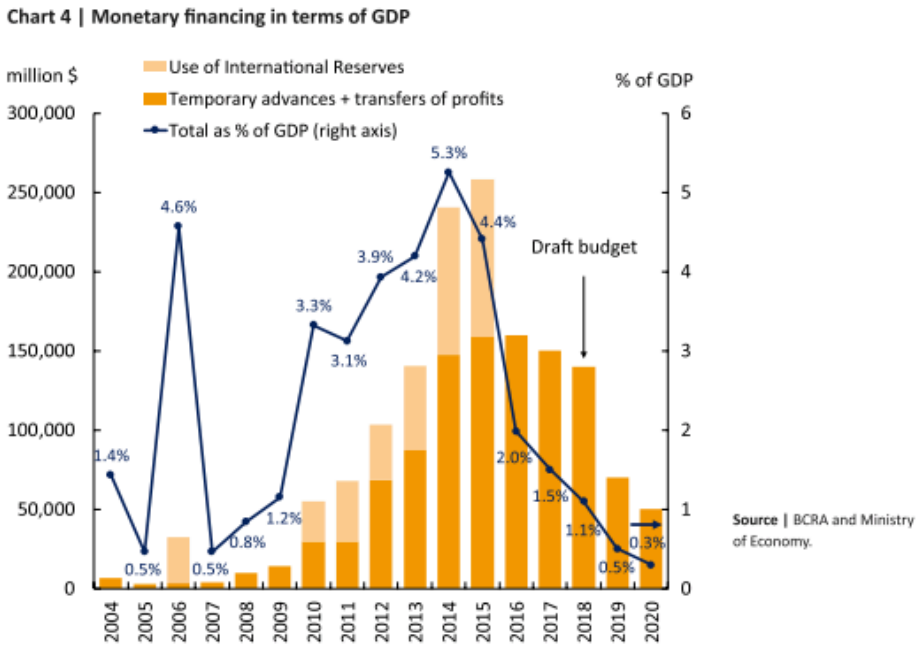

Figure 5.6: Financing of the government by Argentina's central bank (not including non-transferable securities), source: (BCRA, 2018, 10)

5.4.2 Financial policy

Financial regulation Financial regulation had been consistent with the regulatory tightening under Kirchner but was partly adjusted to promote Fernández de Kirchner's developmentalist policy change to encompass the promotion of productive lending and tightening regulations on short-term global financial flows. Macroprudential regulations on international financial flows were aimed at promoting productive investments and to facilitate foreign debt repayments (BCRA, 2014, 17). Given increased capital flows due to currency depreciation and inflation pressure, capital controls were adopted in November 2011. In addition, *Certificado de Depósito para Inversión* (CEDIN) were issued by the Bank in 2013 to catch U.S. dollar-

denominated assets held by the private sector to promote productive public investments.

The Capital Market Law was adjusted in November 2012 to end self-regulation of market actors and promote capital market development by increasing access to it, particularly of SMEs. In February 2014, limits to the net global position of foreign currency were reintroduced that had been discontinued in May 2005. A Liquidity Coverage Ratio was introduced in January 2015 to accommodating the new Basel III standards. In general, capital regulations were tight and in line with the Basel standards (BCRA, 2012a).

Public financial institutions and institutional investors To promote Fernández de Kirchner's developmentalist policies, public funds were established for propelling private consumption and investments. Furthermore, Menem and Cavallo's pension reform of 1993 were reversed to access pension funds for financing rising public expenditures. In December 2008, the Argentine Integrated Pension System (SIPA) replaced the private pension funds (AFPs) and transferred their funds to the Sustainability Guarantee Fund (FGS). The FGS was mandated with the objective of promoting both economic economic development and domestic capital markets, investing up to 50 percent of its assets in productive projects (in effect it was only around 11-12 percent between 2009 and 2012). Foreign investments, such as conducted by Chile's public funds to enhance the capacity to counter global financial volatilities, were forbidden. The major position of the FGS was the financing of public debt (62 percent in 2009). In addition to pension assets, per regulatory change in October 2012, also insurance companies had to shift their assets to productive investments.

Furthermore, a number of further public funds were introduced to promote the developmentalist strategy, entailing funds to improve financing conditions for SMEs, the development of real estate but also enhancing the access of consumer credits: Argentine Bicentenary Credit for Single Family Housing Programme (2012), National Fund for the Development and Strengthening of Micro, Small and Medium Enterprises (2012), Car Credit Program (2014), National Bank for Technological and Social Development Projects (2014), Fund for the Argentine Economic Development (2014), and Program for the Promotion of the Consumption and Production of Goods and Services (2014).

5.4.3 Foreign exchange policy

Foreign exchange policy followed the objective of supporting debt payments, thus making the objectives of safeguarding financial stability and promoting the export industry secondary concerns. In combination with market interventions to stabilize the peso, this ultimately lead to a significant depletion of foreign exchange reserves since Marcó del Pont took over in early 2010 (see Figure 5.5).

Shifting away from financial stability as main policy objective, Fernández de Kirchner's combination of developmentalist and Keynesian expert knowledge to inform policy change induced stronger state interventions to shape conditions in the financial and economic system compared to her predecessor. When the economy slowed down during her second tenure, problems that characterized Argentina before Kirchner re-emerged. Although foreign debt was contained, capital flight, black markets, and current account deficits returned.

5.5 Macri: The return of neoliberalism

Having served two consecutive terms as president, Fernández de Kirchner had to leave office in December 2015. Against the background of financial and economic instability, the candidate of the Peronist camp (Daniel Scioli) lost narrowly against the neoliberal Mauricio Macri from the Republican Proposal (PRO), a party he co-founded in 2005. For the third time since Menem's neoliberal turn, a significant change of policymaking occurred. Next to the standard set of neoliberal policies (reducing fiscal expenditure taxes, tariffs, subsidies, and privatizing public policies), it was particularly the floating exchange rate that was the central characteristic of Macri's policy change. Although resembling the approach of experts during the *Convertibilidad* and their belief in liberalized financial markets, neoliberal experts appointed by Macri did not go so far to completely give up monetary and foreign exchange policies. Instead of adopting a peg, a floating exchange rate regime was embraced with the belief that this would preempt speculative financial flows. Financial markets are to be regulated but were opened again to international financial flows.

In December 2015, Macri's new policy approach was established with the appointment of Frederico Sturzenegger to head the Bank, after his pre-

decessor Alejandro Vanoli left office following Scioli's electoral defeat. The selection of Sturzenegger to inform policy change induced a translation of neoliberal expert knowledge that was strongly influenced by Western norms of monetary, financial, and foreign exchange policy. Following these norms, Sturzenegger believes in the efficient credit allocation of free financial markets and in the necessity of limiting the objective of monetary policy to price stability - when inflation is curtailed, economic growth will return, according to this expectation (Sturzenegger, 2016d,c, 2017b). He thus follows a monetarist understanding of monetary policy, which implies that inflation is simply a result of too much money in the system (Sturzenegger, 2016d). The central bank thus needs to reduce the circulating money, discontinue credit policy, stop financing the government, and liberalize the financial system, to foster economic growth (Sturzenegger, 2017e,d).

Although he has an academic background, Sturzenegger previously gained experience in the political sector as he worked under Cavallo in the Ministry in 2001 and as parliamentarian for Macri's *PRO* in the Chamber of Deputies (2013-5). He was in direct opposition to Marcó del Pont in his emphasis that monetary, financial, and foreign exchange policies are not a political but merely a technical exercise that needs to be conducted by (neoliberal) economists (see Sturzenegger (2017c)). He gained a PhD from Massachusetts Institute of Technology, was economics professor (UCLA and Harvard in the U.S. and Torcuato Di Tella University in Argentina), and made several academic publications. According to him "[neoliberal] economics provides a framework for thinking about the real world in a more provocative, challenging and ultimately correct way" (Sturzenegger, 2016a). Sturzenegger believed that Argentina just needs to copy monetary, financial, and foreign exchange policies that were adopted by Western advanced economies, and economic growth and financial stability will automatically come about. Sturzenegger continuously refers to Western central banks like the Federal Reserve as standard of reference that should be strived to (and not their monetary policy making the time when they were less advanced as proposed by Marcó del Pont). The only policy problem is to achieve the convergence to global best practices and to to become a "normal country":

> *[I]t is just a matter of taking advantage of international experience. To learn from the path already traveled by others. In this way, instead of trying to re-invent the wheel, instead of replicating mistakes that have already been made throughout interna-*

> *tional history, instead of thinking that we are going to do everything better, we choose the path of working on what has already been learned in other parts of the world [...] We simply have to implement the monetary policies that worked, and dare to face the challenges involved in changing the history of our country* (Sturzenegger, 2016b)

Given this new policy approach and the repayment of the last vulture funds in early 2016, Macri could improve relations to the international finance community significantly. For the first time since 2001, the government could access international capital markets again. However, similar to the 1990s foreign debt increased significantly again both for the public (Figure 5.7) and private sector (Figure 5.8). Households used the chance to exchange peso-denominated to USD-denominated assets. Yet another time, it was increases of the policy rates by the U.S. central bank in 2017 and 2018 that triggered market volatilities and liquidity problems in Argentina. Again, foreign debt could not be rolled over. Like in the late 1990s/early 2000s, the IMF was called for providing financial support in June 2018, when the biggest Stand-by Arrangement by the IMF to date (USD 50 billion) was approved. The agreement contained demands for structural reforms, including the need to update the Bank Charter to increase its independence and discontinue transfers to the government.[14] When financial markets deteriorated further in 2018, Macri's appointed Governor Sturzenegger had to leave office after his relationship with Macri grew tense (Clarín, 2018). He was replaced by Luis Caputo, also member of Macri's PRO, who was transferred from the Ministry of Finance to take the job. To regain control over a deteriorating financial and economic system, a price freeze on fuel was announced in August 2019 as well as a restructuring of government securities conducted. Argentina was, again, not able to place debt on international markets.

5.5.1 Monetary policy

Sturzenegger aimed at converging to norms of Western advanced economies in the conduct of monetary policy. This included the swapping of non-

[14] In March 2019, the government sent a bill to Congress to change the Bank Charter. It entailed an increase of independence, the return of price stability as sole objective, and reduction of transfers to the government. Due to a lack of support, this bill did not pass during the remaining months of Macri's tenure.

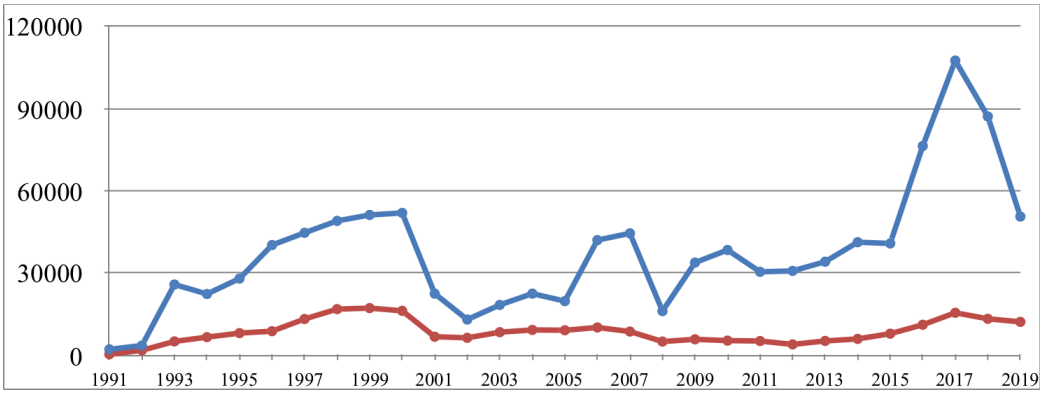

Figure 5.7: Argentina's external debt securities of private sector without banks (red) and the state (blue) (in USD million), source: IMF Database, Balance of Payments and International Investment Position Statistics (BOP/IIP)

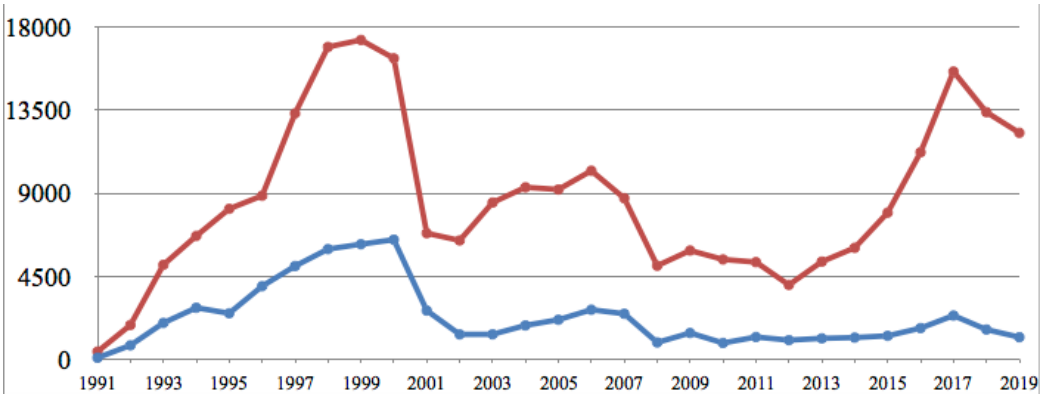

Figure 5.8: Argentina's external debt securities of private non-financial sector (red) and banks (blue) (in USD million), source: IMF Database, Balance of Payments and International Investment Position Statistics (BOP/IIP)

marketable to marketable securities on the Bank balance sheet to reduce the implicit financing of public debt, discontinuation of credit policy (December 2015) and adoption of an inflation target by introducing a short-term policy rate (transition from 35-day LEBAC to the 7-day LELIQ between January 2017 to January 2018).

When financial and economic volatilities emerged, the Bank declared a return to targeting the monetary growth rate in October 2018 to strengthen

control over the financial system. Following monetarist norms to stabilize the currency, the policy rate was strongly increased from 27.25 percent in March 2018 to 68 percent in October 2018. This further weakened the economy by making access to credit more expensive.

5.5.2 Financial policy

Similar to the 1990s, the financial system was liberalized following the regulatory tightening under the Kirchner governments, particularly concerning international financial flows (see Table 5.2). This included the liberalization of transactions by foreign exchange bureaus, agencies, and offices as well as the deregulation of outward direct investments by Argentine companies, the elimination of unremunerated reserve requirements, liberalization of international derivatives transactions, and the elimination of requirements concerning the duration of financial inflows. In July 2017, stricter regulations were imposed on public debt holdings of financial institutions. Financial regulations were adjusted to Basel III norms, including the adoption of regulations of systematically important banks (January 2016), countercyclical capital buffer (April 2016), Leverage and Net Stable Funding Ratios (January 2018).

Given renewed financial volatilities since 2018, Macri's government was forced to induce a renewed regulatory tightening of international financial flows. With the reintroduction of the Net Foreign Currency Position in May 2018 (it had been lifted in June 2016), regulations of international financial flows returned. Capital controls were reintroduced and limits to the purchases of foreign assets for no specific use reinstated. In October 2019, dollar purchases were limited to USD 200 per month for individuals from the previous USD 10,000 a month. These regulations were complemented in September 2019 when export companies were obliged again to sell their foreign currency incomes in the domestic market.

Control over financial flows via public financial institutions and institutional investors was partly loosened, such as by ending the requirement for institutional investors to invest in productive projects (January 2016). Notably, Macri continued to use the FSG, which had lost 17 percent of its value since 2015, for financing public debt (see also Página12 (2019); Infobae (2020)). Other public financial institutions were restructured, such as the National Fund for the Development and Strengthening of Micro, Small and Medium Enterprises or discontinued like the Argentine Bicentenary Credit

December 2015	reduction of foreign currency reserve requirements
January 2016	establishment capital buffer for global systemically important banks
April 2016	easing of capital requirements
April 2016	establishment of countercyclical capital buffer
June 2016	lifting of Net Foreign Currency Position
November 2016 & April 2017	allowing the use of foreign currency deposits for lending purposes
December 2016 & April 2017	easing foreign exchange operations by financial institutions
January 2017	allowing banks to pay interests on deposits in current accounts
April 2017	increasing limits to financial transactions transfers in both domestic and foreign currency
January 2018	introduction of Net Stable Funding Ratio (Basel III)
May 2018	Net Foreign Currency Position was reintroduced
November 2018	adjusting the regulatory frameworks for financial markets (Law 27.440): adjusting derivatives regulations, lowering taxes for productive investments by mutual funds, promoting access to new funding sources for SMEs

Table 5.2: Regulatory changes of Argentina's financial system under President Macri

for Single Family Housing Programme (Government, 2020). In an attempt to spur growth of domestic capital markets, Sturzenegger copied Chile's use of the *Unidad de Fomento*: *Unidades de Vivienda* (UVI) and *Unidades de Valor Adquisitivo* (UVA) were introduced as indexed measures of account (Sturzenegger, 2017a). However, capital and financial markets did not experience significant growth during Macri's presidency.

5.5.3 Foreign exchange policy

In December 2015, Macri and Sturzenegger announced, in one of the first decisions of the new government, the removal of restrictions on the foreign exchange market and the end of foreign exchange interventions to let the price of the peso float freely. It was believed that the combination of floating exchange rate and free international financial flows will induce discipline on public and private investments. Similarly to the 1990s, this liberalization of the foreign exchange market resulted in heavy financial outflows, a build up of foreign debt, a rapid devaluation of the peso, and a strong current account deficit.[15]

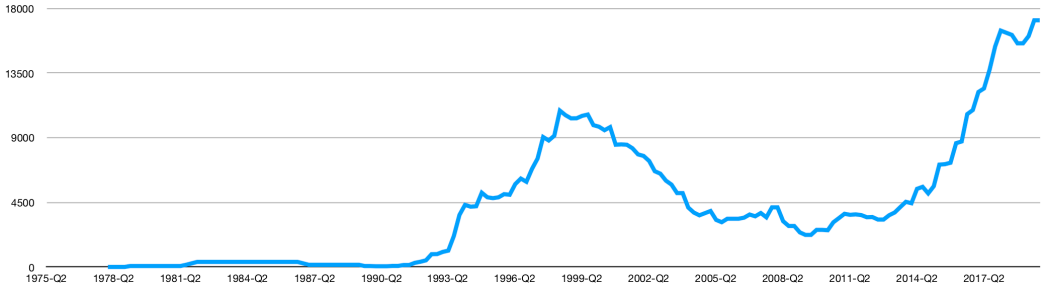

Figure 5.9: Argentina's international debt securities, total amount outstanding, general government, source: BIS Debt securities statistics,

Simultaneously, there was a renewed accumulation of foreign exchange reserves following strong financial inflows between 2015 and 2018 (Figure 5.5). Due to market volatilities, a managed exchange rate regime, with upper and lower limits of non-intervention, was reintroduced under Sturzenegger's successor Luis Caputo in 2018. Since the second half of 2018 and throughout

[15]Figure 5.3 shows how government's foreign debt jumped under the liberalization policies of Macri and Figure 5.9 illustrates the increase of foreign debt securities by non-financial corporations.

2019, foreign exchange interventions were deployed by Caputo to stabilize the foreign exchange market. These interventions were criticized by the IMF, fundamentally resulting in the replacement of Caputo with Guido Sandleris, an economist with close linkages to the IMF (FT, 2018).[16]

5.6 Conclusion

The appointment of experts to key policymaking position was throughout the four observed periods consequential in affecting policy change. Fernández de Kirchner and Macri's policy choices fit well into structural explanations about policy change as they appointed experts from established developmentalist respectively neoliberal policy networks, and were concerned to satisfy their key voter base. This was different with Menem and Kirchner whose strategic consideration in the appointment of experts induced policy change that can only insufficiently explained by structuralist theories. While the former turned away from key Peronist electorate and supported privileged groups in society, the latter pursued a conciliatory approach, forging compromises between opposing groups in society. By selecting Cavallo and Redrado as outsiders to their respective policy networks for informing policy change, they exerted political agency. It seems unlikely to assume that similar policies would have been adopted if they had selected experts as they were previously expected to.

There are other factors that shape the observed policy outcomes and affect the comparability to policy change in Chile. Although both countries are presidential democracies in which decrees can be used to force policy change, key decisions like Macri's attempt to reform the Bank Charter failed due to a lack of majorities in the bicameral Congress. These majorities are more difficult to obtain than in Chile, given a more fractured party landscape and stronger divisions across the provinces as well as between the federal capital and the rest of the country. In Argentina, a convergence of parties similar to the *Concertación* in Chile which resulted in a unified policy network did not occur. This also entailed the relation of the incoming democratic governments to the military dictatorships, which was much more confrontative by Argentina's Raúl Alfonsín than under Chile's *Concertación*. This

[16] Although a strong supporter of central bank independence, this episode indicates that the IMF itself would intervene in the policies of independent central banks if the governor acts in an undesired way.

included the sentencing of Dictator Vidal to jail for lifetime - a decision that was turned around under Menem but reinstated under Fernández de Kirchner in 2007 (see Huser (2002)). Instead, two opposing policy networks have continued to exist, that include tight interlinkages between politicians, experts, and private interests. This lack of convergence around one type of expert knowledge made policy continuity in Argentina less likely to occur - the reversal of Kirchner's relative successful policies by Fernández de Kirchner after 2007 is a case in point. Lack of continuity is also expressed in the frequent replacement of key policymakers before the official end of tenures, often due to strategic concerns by government leaders or conflicts between them and key policymakers. The high turnover rate of governors occurred even though the Argentine central bank gained independence in 1991 (see Table 5.1). Central bank governors have been recurrently replaced not only when governments changed but also when it was convenient to do so for the president (scapegoating). Even the neoliberal Macri, who condemned populist policies and emphasized the need for central bank independence, fired two central bank governors when it was convenient for him to do so.

In spite of Argentina's fragmented political system with strong provincial leaders and multiple veto points, policy change was considerable. The appointment of experts with strong, often ideological beliefs regarding which policies are necessary to overcome Argentina's problems further propelled this change. For example, it would be unlikely to assume that Menem would have induced the dogmatic *Convertibilidad* experiment without the appointment of Domingo Cavallo, or that Kirchner would have pursued similar pragmatic policies if he appointed an expert from the developmentalist policy network. That structures continue to have an important effect on policy change can be seen with Fernández de Kirchner and Macri, who appointed experts to induce policy change that belong to well established expert groups: In case of Sturzenegger, he even belonged to the same party like Macri; in case of Marcó del Pont, she was funding member of *Grupo Fenix* and affiliated with developmentalist research institutions.

Another factor that played into policy change in Argentina was the IMF. While Chile was successful in increasing independence from it after its successful recovery in the 1980s, Argentina had to continuously consult the IMF on policymaking as it frequently had relied on its liquidity support in the 1980s, early 2000s, and late 2010s. Only during the temporary stability during the *Convertibilidad*, the IMF did not intervene in Argentine policymaking in spite of the buildup of financial risks, which was heavily criticized

by Argentine policymakers after the 2001 crisis. Subsequent to the 1982 crisis, Raúl Alfonsín adopted a more confrontative approach to the IMF than Pinochet and Büchi did in Chile (see NYT (1987)). In contrast, Kirchner could smooth the relationship with the IMF as he was eager to quickly repay the debt to the IMF to regain sovereignty over domestic policymaking. The relations to the IMF and the international financial community deteriorated again significantly again under Fernández de Kirchner, who drew criticism for the nationalization of YPF in the international financial community and, among others, criticized the IMF openly in the UN General Assembly in September 2012. In a tit-for-tat, the IMF censured Argentina since 2013 due to statistical manipulation (see Fernández de Kirchner, 2012; Bloomberg, 2013; NYT, 2012). The relation to the IMF improved under Macri before it worsened again under current president Alberto Fernández (see Reuters, 2016; WSJ, 2019). With the exception of Kirchner's presidency, governments did not hesitate to induce partisan politics to satisfy their own voters. This led so far that presidents were frequently charged with corruption crimes after they left office, including Menem, Fernández de Kirchner, and Macri.

Private interests, politics, and experts have often been closely interrelated. Examples include Luis Caputo (worked for several financial institutions like Deutsche Bank and was briefly governor of the Bank in 2018 after heading the ministry of finance for one and a half years), his successor Guido Sandleris (was economics professor, worked for an investment company, and the finance ministry under Macri before becoming central bank governor in September 2018). Governor Sturzenegger was not only party member of Macri's PRO but also was Congressman before taking office. Governor Prat-Gay (2002-4) was Congressman for Civic Coalition ARI (2009-13) that will later enter a coalition with Macri's PRO under which he was finance minister (2015-6). He also founded a consultancy firm and worked in private banking, including for JP Morgen (1994-2001) during the 2001 crisis, thus having a direct interest in the debt repayment of Argentina.

Unlike in Chile, compromises were not pursued to bridge cleavages in the internally divided country that suffered frequent military coups as well as political, economic, and financial instability. Whereas stability was propelled by political choice of the *Concertación* to adopt policies from the dictatorship, the return to democracy in Argentina under President Raúl Alfonsin (1983-9) was characterized by instability and division that has not been resolved until today. While there are several structural factors, including differences of the political system, that help explain policy divergence in these two coun-

tries, this chapter aims to show that the appointment of experts at critical junctures enhances existing explanation of the observed policy change.

Monetary, financial, and foreign exchange policies played only one factor among many that explain Argentina's continuous dire financial and economic situation. One noticeable difference to Chile was the use of pension funds to finance public debt instead of propelling domestic capital markets and accumulating foreign reserves to promote independence from global finance and help safeguard financial stability. Also the decision to consolidate debt via non-marketable securities on the Bank balance sheet since the 1980s instead of using it to promote domestic capital markets did not support stability.

The political selection of expert knowledge in the East Asian cases has been, like in the Latin American cases, consequential in shaping policy change. A key difference between the two pairs is the role of the bureaucracy, which has been a powerful actor for policymaking during Japan and South Korea's developmentalist era (1945-1990s), and the big conglomerates (*kereitsu* in Japan, *chaebols* in South Korea). In contrast to the relative direct impact of prime ministers on policymaking in Argentina and Chile, governments in Japan and South Korea in their pursuit of inducing policy change faced the resistance from these actors. Thus in both countries, governments developed strategies to shift the balance of power in their favor, using expert commissions to develop blueprints for reforms while using times of crises to execute institutional and policy change in the late 1990s. Policy control by the government was strengthened after modification of (developmentalist) institutional structures.

Even against the presence of these differences that affected policymaking, also in the cases of Japan and South Korea the appointment of experts to key policymaking position has been consequential in terms of shaping policy change and policy substance. Expert commissions played an instrumental function for governments that aimed at sidelining the bureaucracy from the development of blueprints for institutional and policy change. Thus both political agency (to conduct institutional change and change policy direction) and expert agency (to determine policy substance) are identified in both cases. The empirical findings lends further support to the expectation that the political selection of expert knowledge is consequential in terms of shaping policy change. While in some periods, particularly in Japan under Prime Ministers Hashimoto and Koizumi, policy converged to Western norms, this was different in other periods, such as under Prime Minister Abe. Also in South Korea, where policy substance diverged significantly subsequent to the 1997 crisis.

Chapter 6

South Korea

This chapter demonstrates how the selection of experts to key policymaking positions by the government has informed policy change in South Korea. Additionally, experts have been instrumental for governments in inducing institutional change. For being able to empower new expert knowledge to inform policy change, governments had to overcome domestic resistance of two actors that were at the center of South Korea's developmentalist era (1945-1993): the bureaucracy (particularly the Ministry of Finance) and the large conglomerates (*chaebols*). While the former aimed to defend their central position in the policymaking process, the latter wanted to make sure that it maintained a privileged position compared to their domestic and international competitors. Since the 1980s, governments attempted to change these developmentalist structures with different degrees of intensity. It was only with President Kim Dae-jung (1998-2003) that institutional reforms were enacted which significantly reformed Korea's developmentalist structures and induced policy change. Similar to Argentina and Chile, it was a financial crisis (1997) following initial financial liberalization that triggered policy and institutional change.

South Korea's management of its liberalized financial system can be divided into two periods: First an era of unregulated international financial flows (1993-7) followed by financial stability-oriented policies (since 1998). Similar to the Latin American cases in the 1970s, South Korea faced international pressure, particularly from the United States, to open the its financial in the 1980s. However, liberalization under the presidencies of Chun Doo-hwan (1980-1988) and Roh Tae-woo (1988-1993) was slow and gradual, unlike in Argentina and Chile. Only under President Kim Young-sam (1993-

8) Korea's financial system was opened to large-scale international financial flows that were, similar to Argentina and Chile in the 1970s, not accompanied by the adoption of new policies to regulate them. As a result, financial risks built up that unravelled in a financial crisis in 1997 when panicking global investors pulled out their financial investments after a currency crisis in Thailand in July 1997 spread over the continent. The government of Kim Dae-jung (1998-2003) used this crisis, taking advantage of pressure from the IMF to not only induce change to monetary, financial, and foreign exchange policies but also to implement institutional change that strengthened the power of the government over these policies vis-à-vis the bureaucracy.

Two instances are identified where political agency was exerted through the appointment of experts to key policymaking institutions that subsequently informed policy change. Firstly, Kim Young-Sam and Kim Dae-jung established expert commissions to sideline domestic opposition and inform institutional and policy change in the 1990s. Given that responsibility over policy change during the developmentalist era was within the bureaucracy, these expert commissions became instrumental to develop blueprints of reforms favored by the government. When the the 1997 financial crisis temporarily weakened the power of Ministry of Finance and the *chaebols*, the government used this window of opportunity to execute these blueprints. These institutional reforms weakened bureaucracies and strengthened leverage of the presidents over controlling monetary, financial, and foreign exchange policies The second instance of agency occurred when President Lee Myung-bak (2008-13) took the strategic decision to give up his neoliberal policy agenda. Instead, he appointed prominent outsiders to key policymaking positions and deepened institutional reforms. These outsiders strengthened policies to regulate international financial flows and informed South Korea's attempt to reform global financial governance in the G20. Given that adopted policies were highly innovative and sophisticated in terms of safeguarding financial stability, expert agency was conducted was based on experience-based knowledge.

The subsequent section gives a brief overview of the developmentalist era of South Korea (Section 6.1). Next, financial liberalization under Kim Young-sam and institutional reforms under Kim Dae-jung's in the 1990s are analyzed (Section 6.2). Section 6.3 analyzes Lee Myung-bak's selection of experts to inform policy change. Section 6.4 concludes.

6.1 South Korean developmentalism (1945-1993) and financial liberalization under Kim Young-sam (1993-8)

During Japan's brutal colonization of South Korea (1910-1945), Japanese developmentalist ideas were translated into South Korean institutions in a more or less sustainable way (see Thurbon, 2016, ch. 3 and 4; Amsden, 1989, 32-35,47; Clifford, 1994, 26-8, Eckert, 2014, Cumings, 1984; Kohli, 2004; Kohli, 1994; Woo, 1991; McNamara, 1990; Kim, 1992).[1] In the following 4-5 decades, South Korea maintained and strengthened developmentalist policies under authoritarian military regimes. Particularly the regime of General Park Chung-hee (1961-1979), who previously served in the Japanese army, is linked to the use of developmentalist policies to promote export-oriented economic growth which helped to lift the country from being one of the world's poorest country to one of the most successful emerging market economies (Kim and Vogel, 2011; Kohli, 2004, ch.3). The production focus was gradually upgraded under Park, moving from primary products (1950s) to light industry (1960s) and then heavy industry (1970s) (see Kim (2004)).[2]

Economic development was coordinated and controlled by the bureaucracy. They established their own research institutes for informing policymaking (Mo and Lee, 2014, 100). Monetary, financial, and foreign exchange policies were characterized by strong state control over credit allocation, particularly by the Ministry of Finance, Economic Planning Board, and Ministry of Commerce (Yoon and Kim, 1995; Vittas and Cho, 1996; Amsden, 1989). The Bank of Korea was subordinated to the Ministry of Finance, and together with the nationalization of commercial banks, this resulted in a strong state leverage over credit allocation.

Although not a dictatorship, South Korea remained an authoritarian state until massive countrywide protests emerged in 1987 that resulted in the establishment of democracy in the same year. Unlike in Argentina and Chile, there was no translation of Western neoliberal expert knowledge into policies during the authoritarian regime. Instead, the authoritarian governments

[1] In addition to developmentalist ideas of the Japanese bureaucracy, policymaking was influenced by ideas of Friedrich List and John Maynard Keynes (see Kim (1992); Thurbon (2016))

[2] Strategic planning continued also after Park, with focus from knowledge industry (1990s) to inclusive/sustainable/green growth (2000/2010s).

remained closely linked to developmentalist policies and the *chaebols*. The call for market-friendly reforms has thus been deeply associated with South Korea's democratization movement and helped gather support for opposition candidates Kim Young-sam and Kim Dae-jung, both leading opposition figures under the military regimes.

Why was there no such direct translation of neoliberal knowledge propelled by the dominating United States in its war against communism? As South Korea, in contrast to Argentina and Chile, was strongly opposed to communism during the Cold War, the United States was less likely to undermine South Korea's political stability and intervene in domestic policymaking. Given the constant threat from communist North Korea (including the Korean War 1950-53), the United States instead offered political and economic aid to South Korea. When U.S. support became more uncertain under the Nixon doctrine (1969), General Park further promoted economic development by guiding production towards heavy industry, as he saw this as the basis of "national power" (Park, 1970, 124; see also Woo, 1991; Kohli, 2004, ch.2). Moreover, there have not been significant efforts to institutionalize neoliberal expert knowledge by politicians and the bureaucry. Strong bureaucracies that could draw on expert knowledge from their research institutions maintained a tight grip on policy change.

Thus Korean politicians and policymakers were hesitant to adopt Western neoliberal ideas and liberalize the financial system. Instead they committed to a gradual approach to increase benefits from international financial and economic flows without losing control over the financial system (see Lindner, 1994; Amsden and Euh, 1993, 379; Kong, 2000, 75). The active role of the state in guiding economic development, including by shaping credit allocation, was largely maintained (Woo, 1991, ch. 7; Okabe, 2014, Kong, 2000, 80). The lack of strong international power in combination with the advanced expert knowledge produced by the bureaucracy and the lack of crises that served as window of opportunity made rapid policy convergence to Western standards as in the Latin American cases less likely, and allowed a more controlled, gradual approach to financial liberalization.

This gradual approach was initiated with tentative liberalization of the financial system under the rule of General Chun Doo-hwan (1980-1988) who followed as president after the assassination of Park Chung-hee in a *coup d'état* in 1979. Growing pressure from the United States to open its financial system to rebalance the global system and enlarge profitable investment opportunities for global investors, such as in the case of Japan, fueled this

process (see Woo (1991, 183)). But as already stated, the position as key ally against communist enemies, impressive economic growth, and the lack of disastrous crises similar to the 1982 crisis in Argentina and Chile made an extreme policy change towards Western neoliberalism less likely. More serious efforts to liberalize international financial flows and the domestic financial system were conducted under the President General Roh Tae-woo (1988-1993) (Shin, 2003, 116) but economic instabilities in the late 1980s led Roh to postpone further liberalization policies (Bedeski, 1994, 86-7; Thurbon, 2016, 81).

Kim Young-sam's liberalization (1993-7) and the 1997 financial crisis It was only under the presidency of Kim Young-sam, a leading figure in the democratic opposition during the military regimes and the first non-military head of the government since 1962, that international financial flows were substantially liberalized (KIIEP, 1993; Kim and Yang, 2010). This coincided with the weakening of state capacity to conduct developmentalist policies. The power of the liberalization-skeptical Ministry of Finance (Ministry) was reduced vis-à-vis the government, including by its symbolic merger with the neoliberal Economic Planning Board in 1994 to form the Ministry of Finance and Economy (Chang, 1998). Also the Ministry's influential International Finance Bureau was abolished in 1994 (Lee and Hong, 2019, 90).

As a facilitating factor to this institutional reform was the inflow of neoliberal expert knowledge in the Economic Planning Board and the Bank of Korea. Under the guidance of Nam Duck-woo (Economic Planning Board Minister 1969-78), the Economic Planning Board and its affiliated Korea Development Institute increasingly hired neoliberal, U.S.-educated economists in the 1970s as well as in the 1980s (Amsden, 1994; CIA, 1983; former policymaker E, Seoul, 6 March 2019). The government-funded and -dependent Korea Development Institute (KDI) was established by General Park in 1971 to further promote the production of domestic expert knowledge to inform policymaking, including by supporting the Economic Planning Board in its creation of the 5-year economic development plans. It has continuously published research and articles about monetary and financial policy, thus allowing the government to strengthen its position relative to the bureaucracy (Chosun, 2001a). Also the Bank of Korea, albeit to a lesser extent, increasingly hired neoliberal economists in the 1970s and 1980s (see CIA, 1983; Kim, 2011a, 207; Kim, 2004; Clifford, 1994; Kim, 1999; Hwang, 1996, 312;

former policymaker E, Seoul, 6 March 2019). This inflow of neoliberal knowledge resulted in a gradual change of expert knowledge within the state that, however, remained dominated by the Ministry's developmentalist ideas until the institutional reforms in the 1990s. This change in the bureaucracy allowed Kim to promote his *segyehwa* (globalization) agenda that encompassed policies to promote financial liberalization.

Financial liberalization was however left unaccompanied by new regulations to control for attached risks. A boom of unregulated international financial inflows in the mid-1990s, resulting in a rapid buildup of foreign debt like it did in Argentina and Chile in the 1970s. Financial risks were further propelled by non-banks that were established by *chaebols* to circumvent financial regulations (Chang et al., 1998; Kim, 2018; Amsden and Euh, 1993, 383). Since at the same time incoming foreign direct investments remained tightly regulated, *chaebols* could strengthen financial independence from the regulated domestic financial system without having to fear foreign takeovers.

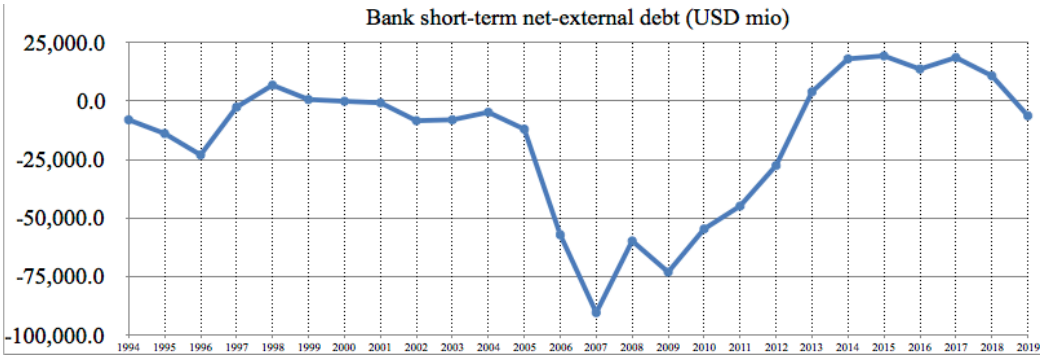

Figure 6.1: South Korean banks' short-term net-external debt (USD million), source: BoK ECOS (8.7.3 Net External Assets)

Given that in the preceeding decades the state was able to prevent any financial institution from going bankrupt, South Korean policymakers did not expect that this would change once international financial flows were liberalized (see Lee and Hong, 2019, 67; Woo, 1991, 13). Similar to their peers in Argentina and Chile, they did not account for risks attached to international financial flows. Against this background, South Korean policymakers lacked instruments to react to financial outflows by panicking global investors after Thailand was forced to give up its dollar peg in July 1997. Considering that the degree of transparency over credit risk was low, the substantial amount

of non-performing loans was only exposed when liquidity dried out. With debt-to-equity ratios of almost 400 percent by 1997, a wave of bankruptcy in the private sector resulted in KRW 45 trillion (USD 37 billion) of bad loans by late 1999 (Park, 2002b).

Similar to Chile under Büchi in the mid-1980s, South Korean policymakers focussed on restoring liquidity and making accumulated debt marketable as quickly as possible. Public funds were used to stabilize financial institutions that were deemed illiquid and to dispose non-performing loans. The public Korea Asset Management Corporation (KAMCO) purchased and subsequently sold them in form of asset-backed securities in newly established capital markets (see below). Institutions that were considered insolvent were resolved. To promote inflow of much-needed foreign finance, the government promoted financial inflows by guaranteeing all foreign debt (August 1997), introduced the Financial Market Stabilization Plan (October 1997), and established full deposit guarantee (November 1997). A maturity extension of short-term foreign debt was negotiated in January 1998. With the support of these policies, South Korea could access international capital markets again in April 1998. Debt-to-equity ratios constantly reduced, reaching 104 percent by 2004.

The path to institutional reform What was the motivation for South Korean policymakers to engage in financial liberalization? Like it was convenient for military dictatorships in Argentina and Chile to draw on neoliberal experts educated in the U.S. that stood ready to translate their knowledge into policies in the 1970s, also for South Korean politicians it was strategic considerations that made financial liberalization a convenient choice. Rather than an objective in itself, financial liberalization was considered as useful means to strengthen the new democracy by overcoming developmentalist structures that built on a close relation between military regimes, bureaucracies, and *chaebols*. Kim Dae-jung, who like Kim Young-sam was a pro-democracy activist, was elected to become president in 1998 based on the promise to consolidate democracy in Korea. In his inaugural address, he emphasized that

> *[d]emocracy and the market economy are like two sides of a coin or two wheels of a cart. If they were separated, we could never succeed [...] I firmly believe that we can overcome today's crisis by practicing democracy and a market economy in parallel*

(Kim, 1998; see also MoF, 1999 for his official policy agenda).

International financial flows were thus expected to promote changes in the economy and democratize the country by reducing the power of bureaucracies and *chaebols*.

At the same time, 1997 crisis experience strengthened the new government's conviction that monetary, financial, and foreign exchange policies had to be changed to regain control over the liberalized financial system. To make policy change according to government preferences feasible, institutional reforms were required. Institutional change was already envisioned under Kim Young-sam's predecessors but although the Ministry was weakened with the 1994 reforms, it could retain control over monetary, financial, and foreign exchange policies. To overcome domestic resistance and propel policy change, Kim Young-sam and Kim Dae-jung drew on expert commissions as a key mechanism (see Choi (2001); Rhee Baum (2007); Kim (2000)). These expert commissions were tasked with developing blueprints for institutional change, entailing the *Segyehwa Committee* (established January 1995) and particularly the *Presidential Committee on Financial Reform* (established January 1997) (see Rhee Baum (2007)). Out of the latter's 31 members, half were full-time economists, the remaining where from business and finance (Hahm, 1998, 1). It laid out a set of reforms, including reforms of financial regulation, monetary policy, and corporate governance (PCFR, 1997). In August 1997, Kim Young-sam integrated various expert commissions to establish the presidential Regulatory Reform Committee under the Basic Act on Administrative Regulations to strengthen the political impact of its policy recommendations (MoF, 2011, 71). The mandate of the Committee was powerful, entailing among others responsibility for deliberating and coordinating the "setting the basic direction of regulation policy as well as research and development of regulatory institution" as well as reviewing and developing proposals for new regulations (Act No. 5368, Art. 24).

With a blueprints for institutional and policy change in place, a critical juncture that sufficiently weakened resistance from the bureaucracy and *chaebols* was missing. This window of opportunity opened with the 1997 financial crisis, for which both actors served as scapegoats. South Korea required temporary liquidity support by the IMF, which implied the need for committing to IMF-supported neoliberal institutional and policy change. And South Korean policymakers were eager to reassure global investors by stating their commitment to the IMF agenda to promote financial inflows.

The open commitment to Western neoliberal institutional and policy change was followed by some converge to Western norms but evidence rather points to the role of the IMF as facilitator for reforms envisioned by Kim Young-sam and Kim Dae-jung. Evidence indicates that IMF pressure served as a catalyst for Kim Dae-jung's government to overcome domestic opposition to institutional and policy reforms that were prepared under expert commissions put in place by Kim Young-sam in the mid-1990s. Most of IMF's demanded reforms of monetary, financial, and foreign exchange policies were already developed in these commissions (see Hahm, 1998, 30; Lee and Hong, 2019, 214-5). Interviewees supported this facilitating role of the IMF, stating that similar reforms would have been adopted eventually, calling the 1997 crisis a "disguised blessing" (Interview former policymaker D, Seoul, 8 March 2019; also Interview former policymaker A, Seoul, 25 February 2019; Interview former policymaker B, Seoul, 7 March 2019). One former policymaker noted:

> *In the sense we were very lucky because we have prepared our reform plans voluntarily. But then the IMF, you know, was actually instrumental in terms of realizing this reform plan to be accepted* (former policymaker C, Seoul, 27 February 2019)

Kang Bong-kyun, presidential advisor of Kim Dae-jung, added that

> *major reforms were about reforming the sectors that we had thought should be restructured, so it was not that we were dragged along by the IMF, but rather we took advantage of the IMF agreement* (as quoted in Lee and Hong (2019, 220)).

Furthermore, South Korean policymakers disagreed with the IMF's crisis analysis and policy prescriptions. While the IMF interpreted this crisis as one driven by economic fundamentals, Korean policymakers understood it rather as a case of panicking global investors and temporary liquidity problems. In a report from 2003 (*The IMF and Recent Capital Account Crises*), the IMF later admitted that the perspective of their South Korean colleagues was correct and that it failed to see financial risks until "virtually the last minute" (IMF, 2003, 2).

Without causing tensions with the IMF and global investors to prevent a return of financial volatilities (such as Fernández de Kirchner did in the early 2010s), South Korean policymakers were carefully carving out domestic

agency to propel institutional and policy change. They were determined in maintaining their own approach not only for the resolution of the 1997 crisis. As the next section shows, this domestic control over reforms also pertains to change of monetary, financial, and foreign exchange policies.

6.2 Developing a financial stability policy framework - post-1998

The previous section indicated how experts were instrumental for politicians to inform institutional and policy change. While this was a case of political agency deployed by the government, this section analyzes the content of the institutional reforms and demonstrates how this was complemented by expert agency to inform substance of policy change. Like the 1982 financial crisis was constitutional to subsequent policy change conducted by Chilean policymakers, the 1997 crisis experience was a watershed moment for their South Korean colleagues. This experience shaped policymakers understanding of the financial system which was translated into policy change directed at financial stability. South Korea recovered quickly from the crisis, paid back IMF debt ahead of schedule in August 2001, and returned to a path of economic growth. Having interpreted the 1997 crisis, unlike the IMF, as primarily liquidity-driven crisis, Korean policymakers used liquidity injections to quickly resolve the crisis and subsequently changed domestic policies to account for risks posed by global finance. Furthermore, monetary, financial, and foreign exchange policies were adjusted continuously following smaller financial crises in 2003 (credit card crisis), 2007 (financial crisis in Western advanced economies), and 2011 (mutual savings bank crisis).

As indicated in the previous section, far-reaching institutional reforms were enacted under Kim Dae-jung who used the 1997 crisis to overcome opposition of the bureaucracy and the *chaebols* (Rhee Baum, 2007; Kalinowski, 2009). The Ministry's responsibilities were curtailed: Its control over financial policy was reduced and monetary policy was delegated to the newly independent Bank of Korea (December 1997). This way, the Ministry's power to steer credit allocation was reduced. The previously dispersed responsibility for financial supervision (which was under the overarching guidance of the Ministry) was integrated in the newly created Financial Supervisory Service (FSS) (January 1999), financial regulation was delegated to the new

Financial Supervisory Commission (FSC) (April 1998), and both became subordinated to the prime minister. The newly independent FSC took over powerful instruments from the Ministry, including its influence over the appointment of directors of commercial banks (Lee and Kim, 2018; Chosun, 2000b; KJAD, 2018b). Additionally, the Ministry's budgetary competence was delegated to the newly founded Ministry of Planning and Budget in May 1999.

At first glance the Bank of Korea (Bank) was strengthened by being granted independence. However, with its increased autonomy it lost powerful tools to control financial flows and instead it was tasked with the more technical than political task of setting the policy rate and injecting liquidity in times of market volatility (former policymaker B, Seoul, 7 March 2019; former policymaker E, Seoul, 6 March 2019; former policymaker A, Seoul, 25 February 2019; see also BoK (2010a)).[3] Furthermore, the Bank could not achieve one of its key objectives: to independently appoint of its policymakers (former policymaker A, Seoul, 25 February 2019). Since the reform, the policy board has been headed by the Bank governor who is to be appointed from the president. The board remained filled with external members: the Ministry, Bank, FSC, Korea Chamber of Commerce and Industry, National Banks Federation, and Korea Securities Dealers Association can recommend one board member each.[4] Additionally Government exerts pressure over "private organizations" that recommend board members (Lim, 2012, 688).

Whereas particularly neo-institutionalist scholars emphasized the convergence to Western neoliberal norms, this would thus miss the domestic political considerations embedded in these institutional reforms: to reduce the Bank and Ministry's power over the financial system while simultaneously strengthening control by the president. As one interview partner stated,

> *our decision is more limited to those monetary policy issues only [...] if [the] Bank is so powerful, then nobody likes the independence. Especially politicians want to control it because it's*

[3]As one interview partner remarked, "the government [...] want[s] to get [its] financial supervisory power. They wanted to deprive it the power from the Bank of Korea" (Interview former policymaker E, Seoul, 6 March 2019). As emphasized in the previous section, this is a hard cut given that the Bank had a high degree of control over interest rate, hence determining who gets credit at what price (former policymaker A, Seoul, 25 February 2019).

[4]Since the revision of the Bank Act in September 2003, the vice-governor of the Bank replaced the member of the Securities Dealers Association.

> *so powerful [...] why should [politicians] delegate it to somebody else? No, it's nonsense. So now [the] Bank is less powerful* (Interview former policymaker A, Seoul, 25 February 2019)

Institutional reforms resulted in significant change of the *form* of institutions, this remaining parts of this section analyzes their *substance* in terms of policies: Did policy converge to Western norms?

The content of the 1997 Bank Act gives a first indication that policies are not expected to fully converge to Western norms. It instead entails several elements that indicate policy continuity with the (developmentalist) past. This pertains to the maintenance of credit policy as policy instrument (Art. 1), a close coordination of the Bank's policies with the government (Art. 4, 6, and 91), and the possibility of loan extensions to the government (Art. 75,76, and 77). A further deviation from Western standards is the role of non-economists and non-central bankers in the policy board, as denoted in Article 13. Under its seven members, 4 are proposed by other institutions (see above). Only the Governor and the Deputy Governor are representing the Bank but both are appointed by the president (Art. 32 and Art. 36).

President Kim Dae-jung's appointment of Chon Chol-hwan to become the Bank's governor in March 1998 mirrored the new policy direction after the 1997 crisis (see Table 6.1). As a former employee of the neoliberal Economic Planning Board and with a firm belief in the benefits of financial liberalization, Chon perceived that the Bank needs to promote the development of the financial system (Chon, 1998e). Aligned with his president, Chon stated that "[w]e all recognize that rebuilding the economy on market principles is the one and the only way to achieve a lasting recovery from the crisis" (Chon, 1998a), perceiving the 1997 crisis as "impetus for further and sweeping reform" (Chon, 1999a). Chon emphasized that by liberalizing the financial system, inefficient allocation of loans to unprofitable companies (particularly *chaebols*), would discontinue (Chon, 1998d). By promoting the development of domestic public and private capital markets, market discipline shall limit bad investments (Chon, 2000). Corporate control mechanisms were to be improved by combining the curtailing of "the hegemony of majority shareholders" (elite families that control *chaebols*) with the improvement of transparency mechanisms and the promotion of inflow of foreign direct investments (Chon, 1998c).

While these statements seem very much aligned with Western neoliberal norms, it was nevertheless clear to Chon that financial liberalization

Governor	Academia	Work
Chon Chol-hwan 1998-2002	professor at the Department of Economics at Chungnam National University; degrees from Seoul National University and Manchester University; published several academic books and papers	Economic Planning Board; IMF; Bank (1983-2002); chairman of the Public Fund Management Committee
Park Seung 2002-6	professor of economics at Chung-Ang University; degree from Seoul National University; PhD from the State University of New York; published several academic contributions	chief presidential secretary for economic policy; Bank (1961-1976,1986-8); Economic Development Five-Year Plan Coordination Committee 1986; worked in ministries under Chun, Roh Tae-woo, Kim Young-sam, Kim Dae-jung, Roh Moo-hyun
Lee Seong-tae 2006-10	degree from Seoul National University	worked for the bank since 1968, Cice Minister of Finance 1991
Kim Choong-soo 2010-4	professor at various universities; degree from Seoul National University; PhD from the University of Pennsylvania	Ambassador to OECD; secretary for economic affairs to President Lee Myung-bak; KDI 1985-91, 93-5; 2005-7; 1997, Assistant Minister and Special Adviser to MoF;
Lee Ju-yeol since 2014	professor Yonsei University 2012-4 ; degrees from Yonsei University and Pennsylvania State University	Bank (1977-2012, 2014- today)

Table 6.1: Background of South Korea's central bank governors since 1998

requires the central bank to conduct liquidity management and induce regulatory reforms to promote a quick economic recovery and to protect the Korean financial system against a repetition of the 1997 crisis (Chon, 1998b; Chon, 1999a; Chon, 1998c; Chon, 2000; Chon, 1999e; Chon, 1999c). This entailed the need for the Bank to help financial institutions to dispose non-performing loans and accompany adjustment processes of non-financial companies (19990414). Regarding foreign exchange policy, Chon articulated that the 1997 crisis made foreign exchange policies and the accumulation of foreign exchange reserves a "crucial concern" for the central bank (Chon, 1999b; see also Chosun (2001c)). In continuity with developmentalist traditions, he furthermore clarified that "we[the Bank] will do all we can, to encourage banks to expand their lending to small and medium enterprises by strengthening incentives" (Chon, 1998b; also Chon, 1999a). Chon pressured commercial banks to extend loans to SMEs and made loan extensions to the real economy a pre-requirement for accessing the Bank's liquidity support (KJAD, 2003a,d), thus deferring from Western ideals of non-interference in investment decisions of financial institutions.

While the official discourse proclaimed a turn to Western neoliberal standards, also seemingly neoliberal policymakers like Chon were convinced that monetary, financial, and foreign exchange policies were necessary to protect domestic financial stability. Chon's interventionist position was shared by other key policymakers, such as Lee Kyu-sung, the minister of finance that time (see Lee and Hong (2019, 143)). Also FSC chair Lee Heon-jae (1998-2000) clarified that the institutional reforms did not imply a fundamentalist turn to free markets, emphasizing that "the absolute logic of the market

or metaphysical economics does not work at all in the marketplace. There is no such thing as absolute principles in the face of economic reality" (as quoted in Lee and Hong (2019, 514)). Policy change was conducted based on the 1997 crisis experience, for which "previous experience and received wisdom provide little guidance" (Chon, 1998b; see also Chon, 1999f; Lee and Hong, 2019, 419,530). For Chon, like for FSC chair Lee it was evident that neoliberal economic knowledge from Western countries is insufficient for informing policymaking in South Korea, instead multiple approaches and combinations of academic disciplines were thought to required to inform policymaking (Chon, 1999d; Chon, 1999f). The production of new economic knowledge and the establishment of a "new financial policy paradigm" ("새로운경제정책패러다임") to guide South Korean policies was perceived as necessary for enhancing "national power" ("國家競爭力") and improving Korea's international standing (Chon, 1999f; Chon, 2001; Chon, 1999g; Chon, 1999d; Chon, 1999h).

Whereas the substance of adopted policies (see below) were influenced by Chon, it is unlikely that they could contradict the government's preferences without a backlash. Although Chon emphasized the ideal of the Bank's independence from influence from the government (Chosun, 1999, 2000a, 2001b,a), in line with Western norms, the government soon clarified the limits of independence. When tensions arose between Chon and the government, such as over the lowering of policy rates in 1998 (Chon was against it as he perceived that this would undermine economic restructuring), the government flexed its muscles. The Ministry's vice-minister Chung Duck-koo remembered how he made this position clear in a conversation with the Bank's vice-governor:

> *It is true that central a bank independence is necessary when it comes to monetary and credit policy. However, what good is the central bank when the Republic of Korea goes broke? If you do not agree with the government on its policy, all I can do is to fire [...] you* (as quoted in Lee and Hong (2019, 120).

Chon's successor Park Seung, appointed by Kim Dae-jung in April 2002, took office when Korea's financial and economic system was already stabilized. Park consolidated the Bank's formal independence, including the discontinuation of the Bank governor's attendance at coordination meetings with the government (KJAD, 2003e) and the 2003 revision of the Bank

Act that replaced the policy board's nominee of the Securities Dealers Association with an *ex officio* position. Park, who was involved in the bank restructuring after the 1997 crisis, continued financial stability-oriented policies. Instead of having to worry about promoting financial inflows like his successor, Park was concerned about strong financial inflows, financial innovations and interconnections, and loose financial conditions across the globe that posed financial risks in form of a buildup of household debt and inflated asset prices in the mid-2000s (Park, 2002a; Park, 2003a; Park, 2003a; Park, 2003c). Three years before the collapse of the subprime bubble in the U.S., Park Seung warned that central banks also in the Western world "must [...] pay greater attention to the possibility of housing market bubbles bringing about financial and macroeconomic unstability(sic)" (Park, 2003a; also Park, 2002a). Asset price inflation and liquidity conditions should be controlled by the central bank (Park, 2002a). To counter these new risks, Park advanced regulatory measures to tackle the asset price bubble by increasing taxation of house ownership, conducting moral suasion of banks to reduce loan-to-value ratios, and promoting housing supply (Park, 2003b; Park, 2004c).

Park also emphasized the importance of the Bank's knowledge production to strengthen the "entirely new paradigm" (Park, 2002a) based on the 1997 crisis experience. Park emphasized that there is no "one-size-fits-all supervisory system that is the optimal for every country", making the production of knowledge that is tailored to South Kore necessary (Park, 2004a). The promotion of domestic research capacities was perceived to be crucial to be capable for reacting to new financial risks that develop in Korean financial system (Park, 2004c; see also Lee, 2006c). Although constant policy adjustments are necessary to manage the evolution of the financial system (Park, 2003a), Park acknowledged that it is nevertheless difficult to be fully secured as "the historical experience is that crises will always break out" (Park, 2004b). Unlike his central bank peers from Western advanced economies that time, Park interpreted the financial system as intrinsically unstable.

President Roh Moo-hyun's (2003-08) appointment of Lee Seong-tae, a Bank careerist and former classmate of Roh (KJAD, 2006; Hankyoreh, 2996), to head the Bank in April 2006 further stabilized the 1997 reforms that were aimed to safeguarding financial stability. Like his predecessors, Lee emphasized that policymakers need to be constantly ready for financial instability to arise given that "the financial sector is intrinsically unstable", particularly due to international financial flows (Lee, 2006a; see also Lee, 2006b; Lee, 2007; Lee, 2009b; Lee, 2008b; Lee, 2009d). Therefore policies needed to be

adopted that aimed at reducing risks from international financial flows and increase independence from them by promoting the development of domestic capital markets (Lee, 2009c).

Political agency in the 1990s was exerted to induce institutional change, increasing government control over policies that were previously coordinated by the Ministry. The appointment of experts to key policymaking positions was a central mechanism through which government control was exerted. With the 1997 crisis experience in mind, the government's agenda was to facilitate the transformation of developmentalist structures while maintaining control over developments of the financial system. The following subsections analyze in greater detail the substance of policies that point to expert agency that was deployed. Since the crisis, financial stability has remained a central concern for the Bank, as reflected in the frequent appearance of 'financial stability' compared to 'price stability' or 'inflation' in central bank governors' speeches (see Figure 6.5).

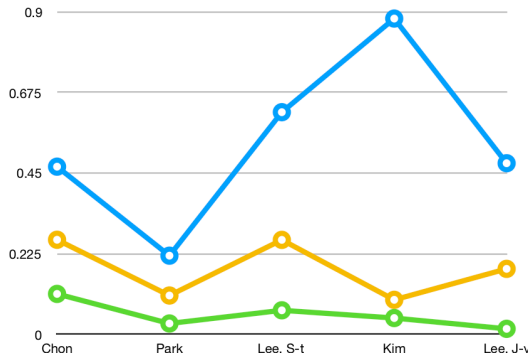

Figure 6.2: Frequency of word occurrence in speeches of policy board members of South Korea's central bank, divided into tenures of governors: 'financial stability' (blue), 'inflation' (yellow), and 'price stability' (green).

6.2.1 Monetary policy

After the 1997 crisis, the Bank institutionalized financial stability as key policy objective and strengthened its leverage over liquidity conditions in the financial system by shifting the operating target of monetary policy from a monetary growth target to the overnight interbank rate. Liquidity provision to the financial system in both won and foreign currency has become the

main task of the Bank to safeguard financial stability next to setting the policy rate countercyclically to stabilize the economy. The 1997 revision of the Bank Act established new instruments for achieving this objective: Liquidity and loans can be extended to companies and financial institutions in times of a credit crunch or liquidity crisis (Art. 80); special loan facilities for financial institutions; and widening of eligible collateral to access Bank liquidity (Art. 64 and 65). Furthermore, the decision of the Bank's policy rate was influenced by rising household debt and increases in asset prices, strengthening preferences for rate increases when asset prices rise rapidly (former policymaker C, Seoul, 27 February 2019; former policymaker D, Seoul, 8 March 2019; former policymaker E, Seoul, 6 March 2019).

During the 1997 crisis, the Bank had to initially increase its policy rate (overnight inter-bank rate) up to 35 percent to counter financial outflows. After the foreign exchange market stabilized in April 1998, the Bank began lowering it again to stabilize the economy (against the advice of the IMF). To counter liquidity shortage and safeguard financial stability, it used open market operations, particularly repurchase agreements, and special loans. Missing other liquidity facilities at that time, special loans allowed the Bank to inject emergency liquidity to banks and via external, pooled funds to non-banks and non-financial corporations (see below). This way the Bank extended KRW 1 trillion to Korea First Bank (September 1997), KRW 1 trillion to 16 merchant banks (October 1997) and KRW 9.6 trillion to other banks, securities companies and merchant banks (December 1997). Moreover, the Bank created a lending facility for banks with export bills as eligible collateral and extended USD 2 billion as loans to export companies that need to import raw materials (Chon, 2000). Lending and liquidity provision to SMEs was promoted via the Aggregate Credit Ceiling (see below) and credit guarantees. To enhance the Bank's capacity for controlling liquidity conditions, a range of policy instruments were introduced, including Intraday Overdrafts (September 2000) and Liquidity Adjustment Loans (June 2000).

Given these policy adjustments, the Bank was more likely to safeguard stability of the financial system when panicking global investors withdrew their investments after the 2007 crisis spread in Western advanced economies. Between then and March 2009, the Bank provided liquidity via open market operations (KRW 18.5 trillion), lending facilities (KRW 2.6 trillion), rising ceiling of Aggregate Credit Ceiling (from KRW 6.5 trillion to KRW 10 trillion), and interest payments on reserves (KRW 500 billion). Moreover, the Korean government introduced guarantees for foreign debt of domestic banks

in October 2008 (Kim, 2009, 278). Furthermore, the Liquidity Adjustment Loans and Deposits Facility was introduced in March 2008 (replacing the Liquidity Adjustment Loans facility) to strengthen liquidity management and to give banks banks the possibility to safely park their money. In contrast to the 1997 crisis, the Bank could additionally lower the policy rate to the all-time low of 2 percent in February 2009 to ease credit conditions. Since financial conditions grew more tense due to panicking investors, this was an important complement to stabilize the domestic economy.

The Bank moreover expanded access to central bank liquidity by widening eligible collateral and counterparties. Accepted collateral for open market operations had regularly been government bonds and government-guaranteed bonds for outright purchases and additionally the Bank-issued Monetary Stabilization Bonds (MSBs) for repurchase agreements. In November 2008, a liquidity shortage induced the Bank to expand eligible counterparties to encompass more securities companies and asset management companies, and it additionally began accepting bank debentures and bonds of public financial institutions. Also eligible collateral for accessing liquidity facilities was substantially widened, encompassing credit securities acquired by financial institutions through loans, government and public bonds, MSBs, debentures issued by the Korea Development Bank, the Industrial Bank of Korea and the Export-Import Bank of Korea, mortgage-backed securities issued by the Korea Housing Finance Corporation, bonds issued additionally by 9 public institutions, and bank debenture.

In contrast to the 1997 crisis, the Bank could take advantage of its accumulated foreign exchange reserves by inject substantial amount of foreign liquidity (USD 22.4 billion) to stabilize the financial system. Additionally it could draw on newly established swap lines to the US Federal Reserve (October 2008) and the People's Bank of China (December 2008), and an expanded swap line to the Bank of Japan (December 2008). As a further backup, the Bank was a founding member of the Chiang Mai Initiative in 2000 that established a network of swap lines between ASEAN+3 states, which was expanded with the establishment of the Chiang Mai Initiative Multilateralization (CMIM) in December 2009 and the CMIM Precautionary Line in July 2014.

A further noteworthy tool that the Bank deployed to not only control liquidity conditions but also influence economic development has been a developmentalist credit policy tool: the *Aggregate Credit Ceiling*. Although the Bank officially stopped the allocation of policy loans in the 1990s, it intro-

duced the Aggregate Credit Ceiling in 1994 (renamed to *Bank Intermediated Lending Support Facility* in 2013). Beyond its task to provide cheap loans to targeted economic sectors (Chon, 1998b; Chon, 2000), this tool was also used to offer liquidity to SMEs in times of instability, such as during the 1997 and 2007 crises.

6.2.2 Financial policy

Financial regulation Following the 1997 crisis experience, the regulatory regime was fundamentally reformed. Core legislation was implemented with the enactment of the Regulation on Supervision of Banking Business in April 1998. In the crisis' immediate aftermath, financial inflows were promoted by adopting a negative list for the regulation of foreign exchange transactions. The Foreign Investment Promotion Act in September 1998 was passed to incentivize financial inflows, delimiting equity holdings by foreigners and allowing them to trade real estate. The Foreign Exchange Transactions Act was established in April 1999. Simultaneously, several policies were introduced to accompany this process and reduce the buildup of financial risks: A Foreign Currency Liquidity Ratio (July 1997), a Foreign-Currency-Denominated Asset-Liability Maturity Gap Ratio (January 1999) and a Domestic Currency Liquidity Ratio (January 1999). In October 1998, accounting and disclosure systems were updated to improve transparency for investments, assess market value, and identify non-performing loans. To have a better control over exchange rate developments, the Foreign Exchange Information System and Korea Center for International Finance (April 1999 and September 2000) were established. A forward-looking criteria of loan classification and mark-to-market valuation on marketable securities were introduced in 1998 and 1999 (Lee, 2011, pp. 269-272). The Korea Accounting Institute was founded in September 1999 to promote this process.

Since then financial financial regulation has been constantly adjusted to account for new risks stemming from the global financial system. As mentioned above, Korean policymakers perceived that financial inflows in the mid-2000s endangered financial stability as they resulted in the appreciation of the won as well as increases in credit and housing prices. To counter these inflows, new regulations were adopted: Limits to Foreign Exchange Positions in August 2002, a Loan-to-Value (LTV) ratio in September 2002 and a Debt-to-Income (DTI) ratio in August 2005. Simultaneously, financial outflows were liberalized in 2005 and 2006 by increasing limits to financial

investments and real estate held abroad by South Koreans.

Public financial institutions and institutional investors Public financial institutions have played two key roles in Korea's financial stability policy framework: foreign exchange management and liquidity provision to non-banks that were not covered by central bank facilities. Before the 1997 crisis, public financial institutions like the National Pension Fund and Korea Post were used to channel their deposits via the Public Capital Management Fund to the government, offering a second, not tax-based fiscal budget that enhanced developmentalist policies (Kim and Stewart, 2011; Jung and Walker, 2009). Following the crisis, state control became less direct, public loans to the government were curtailed, and their objectives shifted.

A main problem of the Bank's policy of accumulating foreign exchange reserves was its costs given that liquid and low-yielding foreign assets were needed to be financed with higher-yielding domestic assets. One strategy to cope with this was that the Bank began purchasing riskier assets such as asset-backed securities, mortgage-backed securities, and corporate bonds (Rhee, 2007). A more problematic issue concerned international politics: The buildup of foreign reserves was criticized by advanced economies, particularly the U.S., that blame reserve-accumulating countries for being "currency manipulators" (see for example Treasury (2020)). Thus President Roh decided in 2005 against the resistance of Park Seung, who was more concerned about liquidity than profitability, to transfer part of the Bank's foreign exchange reserves to public funds.[5] The establishment of the Korea Investment Corporation (assets 2019: USD 157.3 billion, all invested in foreign assets) in 2005 was a direct policy response to these issues (Kim, 2012h). Also the National Pension Fund (assets 2020: USD 637 billion, 35 percent invested abroad), and to a lesser degree Korea Post, Korea Teacher's Pension Fund, and Military Mutual Aid Association have increasingly invested in foreign assets. Public financial institutions thus serve as a strategic resource for managing the liberalized financial system by supporting longer-term stability of the financial system and by promoting the export industry via the limiting of appreciation pressure of the won.

Secondly, public financial institutions have served to provide liquidity to capital markets, non-financial corporations, banks, and non-banks that were

[5]By 2020, the amount of these foreign assets held by these public financial institutions almost equals the official reserves held by the Bank.

not covered by liquidity facilities by the central bank in times of market volatilities, particularly during the 1997 and 2007 crises (see Table 6.2). The Bank contributed capital to these public funds. Thirdly, public financial institutions also act as natural counterparties in foreign exchange transactions by domestic exporters, hence improve financial stability. Fourthly, public financial institutions have been used to channel credit to selected economic sectors and affecting corporate decisionmaking by exerting voting rights as major shareholders. Korea's development banks, in contrast to Argentina and Chile, are numerous and have grown constantly and proportionally to commercial banks since the end of the crisis (see Figure 6.3).

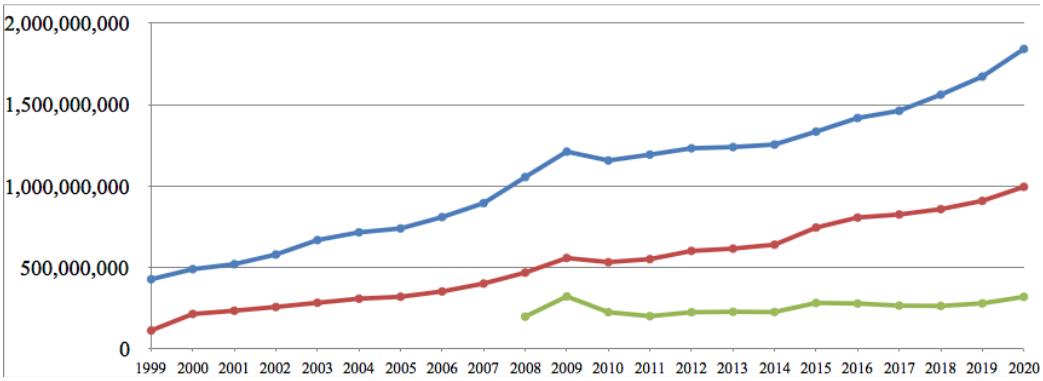

Figure 6.3: Financial assets of Industrial Bank of Korea, Korea Development Bank, NongHyup Bank, Suhyup Bank, The Export-Import Bank of Korea, Korea Livestock Cooperation Federation[closed in 2000], National Agricultural Cooperative Federation [closed in 2011], National Federation of Fisheries Cooperatives[closed in 2016] (red); financial assets of domestic commercial banks (blue) and domestic branches of foreign banks (green) (KRW million, percent), source: Financial Supervisory Service FSIS (Summarized Balance Statement(Assets-Banking Account) 199903 202006)

Developing domestic capital markets The development of domestic capital markets was a key policy objective as it was perceived to increase independence from international financial flows while improving efficiency in the conduct of monetary policy (see 20181119). Firstly, sovereign bond markets were promoted to establish Korean Treasury Bonds (KTBs) as safe asset and benchmark in the financial system. Against the background of

1997 crisis	Korea Securities Finance Corporation to offer liquidity to non-banks
	Korea Non-Bank Deposit Insurance Corporation to offer liquidity to non-banks
	Bond Market Stabilization Fund to reduce liquidity shortage in the bond market following problems at Daewoo
	Korea Land Corporation purchased property of struggling corporations
	Korean Asset Management Corporation promoted debt restructuring by purchasing non-performing loans
2007 crisis	Korea Land Corporation to purchase real estate
	Bond Market Stabilization Fund to stabilize capital markets
	Korea Credit Guarantee Fund (KODIT) and Kibo Technology Fund (KIBO) supported SMEs by offering loan guarantees
	Korea Development Bank channelled funds to Bank Recapitalization Fund and Korea Credit Guarantee Fund
	Korean Asset Management Corporation established the Corporate Restructuring Fund to underwrite bonds of distressed corporations
	Korea Policy Banking Corporation established the Financial Stabilization Fund to include non-banking financial companies for liquidity provision
	Korea Housing Guarantee Corporation bought unsold houses from construction companies under repurchase agreements
mid-2013	Korea Credit Guarantee Fund was used to stabilize funding conditions when the US increased policy rates
2016	Bank co-financed KRW 10 trillion recapitalization of Korea Development Bank and Korea Exim Bank

Table 6.2: Use of South Korean public financial institutions to stabilize the financial system

low amount public debt (8 percent of GDP in 1996) and the subscription of government bonds by financial institutions before 1997, a meaningful government bond market did not exist prior to the 1997 crisis. This changed with the crisis, as financing needs of the state increased (Figure 6.4). In January 1999, a competitive bidding for public debt was introduced with the regularization of government bond issuance and in July 1999, the Primary Dealer System was set up.

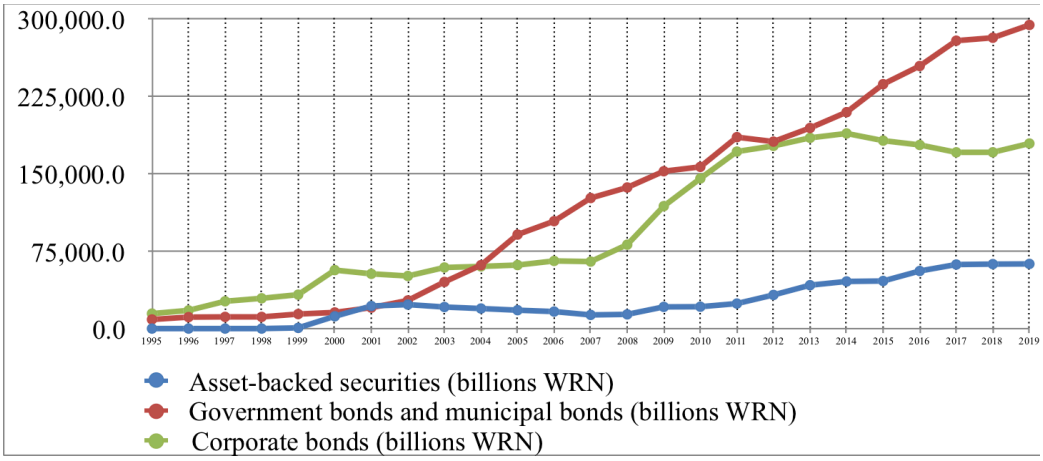

Figure 6.4: Size of South Korean bond markets (KRW billion), source: BoK ECOS (1.6.2 (Liquidity Aggregates),End of)

Secondly, the establishment of asset-backed securities markets helped to dispose non-performing loans left behind by the crisis while simultaneously fostering the development of domestic bond markets. For establishing the yet non-existing market, the Asset-Backed Securitization Act was ratified in September 1998 (see He (2004)). Public financial institutions again played a key role in this process (Park, 2002c). The Korea Deposit Insurance Corporation (KDIC) was managing the resolution of financial institutions while the Korea Asset Management Corporation (KAMCO) was used to purchase their non-performing loans. KAMCO subsequently disposed them by transforming them, among other techniques, into asset-backed securities. Additionally, the public Small and Medium Industry Promotion Corporation, to improve SMEs' corporate bond financing possibilities, underwrote KRW 72 billion of 32 SMEs, issued asset-backed securities and sold them of to private investors with the help of credit guarantees offered by the public Korea Credit Guarantee Fund and Korea Technology Credit Guarantee Fund (see Oh and Rhee

(2002, 245-46)).

Thirdly, foreign exchange and derivatives markets were developed to enhance hedging possibilities by the domestic private sector, including the establishment of non-deliverable forward market (NDFs) and the establishment of the Korea Futures Exchange (KOFEX) in February 1999. Fourthly, the Asian Bond Markets Initiative (established in December 2002 by the ASEAN+3 countries) and the Asian Bond Fund (established in June 2003 by the members of the Executives' Meeting of East Asia and Pacific Central Banks; expanded in May 2005 and July 2011) were used to promote domestic capital market development in the region.

6.2.3 Foreign exchange policy

Following the 1997 crisis, South Korea adopted a floating exchange rate regime in December 1997 and further opened its financial system. While this points to the convergence to Western policy norms, policymakers stood ready to intervene when considered necessary, for example in times of disruptive volatilities in the foreign exchange market (Rhee and Lee, 2005, 197). For developing the capacity to intervene in this market, the accumulation of foreign exchange reserves is necessary. The possibility to draw on these reserves enhances the Bank's control over exchange rate movements and to provide foreign currency liquidity in times of market volatility (see Park, 2004b; Chon, 1999a). As the accumulation reduces appreciation pressure of the won, it additionally enhances the Bank's capacity to control the buildup of foreign debt. Beyond this financial stability objective, the accumulation additionally served a competitiveness objective, as a depreciated currency benefits the competitiveness of the domestic export sector (former policymaker A, Seoul, 25 February 2019). This, in turn, resulted in the U.S. government calling South Korea a currency manipulator (see Treasury (2020, 24-6)), which led the Korean government to disclose currency interventions from March 2019 onwards (which remained undisclosed until then).

The Bank and the Ministry cooperated in the conduct of foreign exchange interventions by either communicating with financial institutions in the markets or by directly ordering major banks to make trades (Lee and Hong, 2019, 105-6; Ryoo et al., 2013, 210; Chosun, 2001c). The Ministry also oversees the Foreign Exchange Stabilization Fund (established in 1967) that serves to stabilize foreign exchange markets, sterilize interventions, and is used as a vehicle to accumulate foreign exchange reserves (Rhee and Lee, 2005). As

mentioned above, a number of public funds are used by the government to enhance foreign exchange management.

6.3 Lee Myung-bak's turn

The second moment of political agency occurred with Lee Myung-bak's election to become president in February 2008. Lee, millionaire and former CEO, was elected on a political agenda that promised neoliberal reforms following the principle of "small-government, big-market". This included privatization of public companies, public spending cuts, pro business policies, and deepened financial liberalization (Lee, 2008a; see also Moon, 2009; WSJ, 2008; KT, 2007; NYT, 2007, GC, 2011; WSJ, 2008; FT, 2008b; FT, 2008a; NYT, 2008a; KT. 2008) . At the same time, the 2007 financial crisis in Western advanced economies resulted in a questioning of the benefits of neoliberalism, making further financial liberalization unpopular.[6] Furthermore, opposition from parliament and bureaucracies as well as widespread public protests against Lee's decision to end a ban on beef imports from the US that was introduced after mad-cow disease emerged in 2003 made Lee's reform attempts more difficult to achieve (former policymaker F, Seoul, 4 March 2019).

It was thus initially uncertain to what extent this context will result in changes to monetary, financial, and foreign exchange policies. Lee chose not to undermine the post-1997 policies but attempted to deepen institutional reforms. Although the reforms of the late 1990s tilted the power balance towards the government, tensions did not disappear. Institutional frictions between government, Ministry, Bank, and FSC have continued under the presidencies of Kim Dae-jung and Roh Moo-hyun, although the general control over policy change has shifted from the Ministry to the president. Even though they not as far-reaching as the reforms of the late 1990s, Lee propelled relative minor but significant changes, including the further weakening of the Ministry by delegating its responsibility for financial policy to the FSC. In February 2008, governance of the FSC was changed by splitting its management, further strengthening presidential control over financial policy (Lee and Kim, 2018, 363-5; Lee and Kim, 2017, 12-3). Furthermore, Lee implemented revisions of the Bank Act in September 2011 to equip the Bank with a financial stability mandate (Art. 1) and in March 2012 to strengthen its

[6]Similar to Argentina and Chile, also South Korea was only marginally hit directly by the 2007 financial crisis and instead suffered from lack of foreign demand.

independence (designated governor is now required to be confirmed by the parliament). The Bank's tools to provide emergency liquidity were expanded (Art. 65, 80), eligible collateral was widened (Art. 64), and new open market operations were introduced (Art. 68). Furthermore, the Bank's capacity to receive information from financial institution and conduct joint examinations with the FSS was established (Art. 87).

Lee wanted to reform old structures of the Bank and modernize it while increasing his control over policymaking. As his approach to monetary, financial, and foreign exchange policies differed from his predecessor's, tensions with him and the Bank's governor Lee Seong-tae arose (KJAD, 2010a; Chosun, 2008). When Lee Seong-tae's term ended in March 2010, he was replaced with Kim Choong-soo, a close affiliate as well as former economic secretary and ambassador to the OECD of Lee Myung-bak, who was more ready to coordinate with the new government (KJAD, 2010c; Reuters, 2010). Kim aimed to break the cohesive bureaucratic structures within the Bank, appointing outsiders and staff from the Ministry (see Kim, 2014b). Weekly meetings with the president and finance minister occurred throughout the year (Reuters, 2012b). One of the first acts was a joint meeting between Kim Choong-soo and Finance Minister Yoon Jeung-hyun in April 2010 in which a close coordination of the Bank and the government was emphasized, also in order to coordinate the challenge in the G20 meeting in November 2010 (BoK, 2010b). For the first time since June 1999, a government representative (Vice Finance Minister Hur Kyung-wook) attended a meeting of the Bank's policy board in January 2010. Since then, Hur and his successors Yim Jong-ryong and Shin Je-yoon participated in the policy committee until February 2013 when Lee Myung-bak's presidency ended (with the exception of two meetings in September 2011 and July 2012). Hur emphasized the independence of the central bank, while stating that "it is time for the government and the central bank to undertake constructive policy cooperation" (BoK, 2010c). New measures introduced by Kim in the Bank included the adoption of joint research projects with external institutions increased from 1 in 2010 to 65 in 2014 and the appointment of Suh Young-kyung, the first woman to become board member (KJAD, 2014b). Kim Choong-soo's reform attempts of the bureaucratic structures were met with resistance from staff members, particularly attempts to appoint externals and promote new expert knowledge (KJAD, 2011, 2014b). Among the governors appointed after 1997, Kim has served as best example on the political push to break traditional structures in the Bank and promote alternative knowledge production

(former policymaker A, Seoul, 25 February 2019, see also WSJ (2012)).

Criticizing old academic models and theories of the past that were promoted by Western advanced economies which contributed to policy failures that resulted in the 2007 financial crisis, Kim emphasized the need for constant production of new expert knowledge in the Bank to "flexibly deal with changes in the external and domestic environments" (Kim, 2011f; see also Kim, 2010g; Kim, 2010d; Kim, 2011g; Kim, 2011c; Kim, 2011e; Kim, 2012d; Kim, 2010a). This new knowledge needs to be adjusted to the specific situation that South Korea is facing and prevent the occurrence of financial crises (Kim, 2011d; Kim, 2011b; Kim, 2013g; Kim, 2012b), as copying expert knowledge and policies from Western advanced economies does not help South Korea to continue economic growth (Kim, 2012a; Kim, 2013e; Kim, 2013f; Kim, 2014b; Kim, 2014a; Kim, 2013g; Kim, 2011e; Kim, 2010e; Kim, 2010g. With regard to the direction of monetary, financial, and foreign exchange policy, there were no significant deviations to his predecessors concerning the primary importance of safeguarding South Korea's financial stability from unregulated international financial flows. Kim Choong-soo pointed out risks attached to the risks of "speculative capital" (Kim, 2013g), financial interlinkages and innovations (Kim, 2010f; Kim, 2011h), and the need for constantly adjusting regulations to counter risks from international financial flows (Kim, 2012a; Kim, 2013f; Kim, 2013a; Kim 2010d; Kim, 2010c; Kim, 2013c).

Beyond these institutional reforms with a domestic scope, Lee used the 2007 crisis to strengthen South Korea's position on global financial governance platforms to push for reforms that will benefit domestic financial stability. Under his presidency, South Korea furthermore became member of the BCBS and FSB in March 2009, co-chaired the FSB's Regional Consultative Group for Asia, and engaged in international central bank platforms like EMEAP, BIS, ASEAN and SEACEN. In a *Wall Street Journal* contribution in March 2009 as well as in his speech at the Davos Forum in January 2010, months before the G20 meeting in Seoul, Lee Myung-bak anticipating a push for changing global financial governance: the adoption of a "global financial safety net", a mechanism that was constantly pushed for by less advanced economies, including Argentina and Chile (see Lee (2009a, 2010)).

Structuralist theories help to explain Lee's strategy, for example explanations advanced by scholars of international relations and international political economy, rationalize why countries aim at increasing their power in the international system. Also it was rational for Lee to reverse from his original

agenda, given the difficult political context. But structuralist accounts do not suffice to explain Lee's appointment of two outsiders, Kim Choong-soo as the Bank's governor (April 2010) and Shin Hyun-song as presidential advisor (December 2009), to key policymaking positions and their role in informing institutional and policy change. Both experts are prominent representatives and are considered to have high credentials on the international level based on their political and academic achievements (see (KJAD, 2010d)). In 1995, Kim worked as South Korean ambassador to the OECD governor to navigate the country's access to the OECD and was Senior Secretary to the President for Economic Affairs (2008) and Korean Ambassador to the OECD (2008-10) before his tenure at the Bank. Furthermore, Kim worked for the KDI (1983-9, 1991-5) and was its president from 2002-5. Similar to his predecessors, Kim reinforced the need for producing expert knowledge in the Bank, but in contrast to them he emphasized the need to develop knowledge for "leading[ing] international society in the directions that we desire, rather than remaining at the level only of understanding the words that others speak" (Kim, 2012e) and undergirding a "transition to a new paradigm to be explored in international forums like the G20" (Kim, 2011d; also Kim, 2013d; Kim, 2010b; Kim, 2012e; Kim, 2013g). It was Kim's explicit objective "to develop and persuade others of the value of ideas that can produce outcomes coinciding with our own national interest" (Kim, 2012b; Kim, 2013g). In line with Lee Myung-bak's aspirations, Kim stated that

> *[t]he key is that emerging economies must take the initiative and devote concerted efforts to convincing various international fora of these proposals and to seeing them through [...] I believe that Korea, too, has reached the point where it must take the lead in contributing to the creation of such an environment in the international arena, and that the Bank of Korea is also not free from this responsibility* (Kim, 2012e).

Thus Korean policymakers called advanced economies to accept responsibility for the effect of their policies on other countries and adjust them accordingly (Kim, 2011e; Kim, 2012c). The rise of macroprudential ideas and the concept of 'financial cycle' were instrumental for strengthening South Korea's position on international platforms. both mentioned frequently in Kim's speeches as governor 6.5. Shin Hyun-song was named chief advisor by Lee Myung-bak for translating financial stability into new policies and for formulating South Korea's agenda for global finance governance reforms

negotiated at the G20. Shin's appointment followed the rationale that Lee wanted a prominent and capable person as his aid to host the G20 summit in Seoul in November 2010.[7]

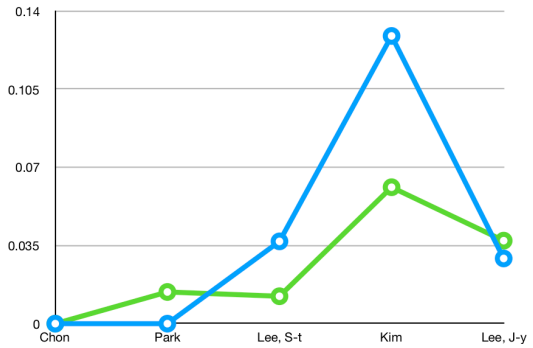

Figure 6.5: Frequency of word occurrence in speeches of policy board members of South Korea's central bank, divided into tenures of governors: 'macroprudential' (blue) and 'financial cycle' (green).

South Korea was successful in inserting some of its ideas in the final G20 communiqué and the Seoul Action plan, including the commitment of advanced economies to account for their policy effects on other countries and intention to improve global financial governance, but concrete policy outcomes were scarce. One interview partner mentioned that G20 was mostly talking, and not walking, especially after the attention of policymakers shifted to the euro zone crisis after 2011, questioning "the necessity and the usefulness of G 20" (Interview former policymaker F, Seoul, 4 March 2019). Also South Korea's push to unify non-advanced economies in the G20 to overcome resistance of advanced economies to substantial global governance reforms failed. As as one interview partner stated, "if you are a lonely voice, then just everyone will disregard these voices" (Interview former policymaker B, Seoul, 7 March 2019; also former policymaker F, Seoul, 4 March 2019). Interview partners complained about the lack of problematization of this issue, not

[7] As one interview partner put it, Lee wanted a "very prominent and capable person as his aid to host the G 20 summit" (Interview former policymaker F, Seoul, 4 March 2019). Although Shin was initially skeptical of leaving his academic position at Princeton University to take the job, he decided to take it due to patriotic motivation (former policymaker F, Seoul, 4 March 2019). Shin said in an interview that "I want to help Korea play a leading role in the G-20 meeting to build a new order" (KJAD, 2009, also Pulse, 2010).

only among advanced economies but also among emerging market economies (Interview former policymaker B, Seoul, 7 March 2019). The most tangible outcome was that less advanced economies were allowed to deploy capital controls when global market volatilities threaten financial stability.

In the face of an economic slowdown, Park Geun-hye from the right-wing Saenuri Party and daughter of Park Chung-hee, became Korean President in February 2013 with the premise of establishing a "disciplined market economy" (Park, 2013). This included the introduction of Choinomics under Park's finance minister Choi Kyung-hwan (2014-6), which entailed the loosening of LTV and DTI ratios, a 10 percent tax on companies that hold too much cash, a lowering of policy rate to enhance demand-led economic growth, and increase in fiscal expenditure. She did not extend Kim Choong-soo's appointment after his tenure ended in March 2014 and appointed Lee Ju-yeol, a Bank of Korea careerist (1977-2012) to head the Bank. Lee, deputy governor under Kim Choong-soo, criticized and reversed Kim Choong-soo's reform course (KJAD, 2014c,d; WSJ, 2014). He dismissed senior officials that were appointed under Lee Myung-bak, including deputy governor Park Won-shik - the first time this has occurred since the 2003 revision Bank Act (KJAD, 2014a). Although domestic real estate transactions were liberalized that propelled household debt, policies remained focussed on regulating the financial system. Lee took a similar stance concerning the need for policies to regulate volatilities of international financial flows, criticizing the role played by Western advanced economies in triggering such, and the need for producing domestic knowledge to protect the domestic financial system (Lee, 2015; Lee, 2016a; Lee, 2016b; Lee, 2017). As Lee stated, the Bank "should consistently work to improve ourselves in order not to be left behind by change" (Lee, 2019). Furthermore, Park Geun-hye articulated more clearly than her predecessors that foreign exchange policy will be shaped to support domestic economy (KJAD, 2013).

6.3.1 Monetary policy

After liquidity-oriented monetary policy instruments were deployed in the context of the 2007 crisis, the situation calmed down and instead a renewed period of financial inflows started driven by low policy rates in Western advanced economies. To improve the Bank's management of liquidity conditions, the 2011 revision of the Bank Act eased pre-conditions for extending special loans and broadened eligible collateral to any banking asset. These

operations not only allow for preventing liquidity shortage of banks but also to improve liquidity in bond markets. Furthermore, new central bank swap line with Canada and Switzerland were established.

Also credit policies have continued to be exercised under Lee Myung-bak and his successors. This included the use and expansion of credit policies, particularly SMEs, to which the Bank has remained committed to. Credit policy is deployed by the Bank to function in a way that facilitates financial institutions' access to cheap central bank loans conditioned on their extending of loans to productive investments, thus contributing to achieving economic development (Kim, 2013b). The historically continuity to developmental policies is expressed by Kim Choong-soo (Kim, 2013f).[8] This aims at preventing situations like in Western advanced economies, where cheap liquidity is not extended to productive investments and instead circulates within the financial system, pushing up prices of unproductive financial assets instead (Kim, 2013b).

6.3.2 Financial policy

Financial regulation In general, the post-1997 regulatory framework contributed to protecting the financial system from severe volatilities. However, there was one major regulatory gap that threatened the stability of South Korea's financial system in 2008 when global investors panicked and returned their investments from the country. This regulatory gap concerned the short-term funding abroad of domestic banks (see Figure 6.1).[9] As domestic banks failed to roll over their short-term foreign debt in 2008, a liquidity shortage occurred that required the central bank to intervene. While policymakers failed to prevent this buildup of risks, they introduced new regulations to prevent a reoccurrence of a similar situation. The Regulation on Supervi-

[8] According to interview evidence, also more informal mechanisms have been maintained from the developmentalist era. One interviewee stated that guidance on credit allocation is still occurring, although to a less degree than during South Korea's developmentalist era, in form of "some degree of unwritten 'coercion' to the private sector" even though "not as strong as 3, 4, 5 decades ago" (Interview former policymaker D, Seoul, 8 March 2019). Another interviewee noted the existence of unofficial ways for the state to shape credit allocation practically (Interview former policymaker E, Seoul, 6 March 2019).

[9] As the export sector sought to hedge its foreign currency risk, local branches of foreign banks were providing foreign currency loans to domestic banks which acted as counterparties to the export sector. The Ministry calculated that these transactions were responsible for half of foreign debt inflows in 2006 and 2007 (FSS, 2010).

sion of Banking Business was amended in December 2009 and 2010 to treat local branches of foreign bank like domestic banks regarding regulations of currency and maturity mismatches.

Further need for adjusting regulatory instruments became urgent when international financial inflows picked up again after central banks in advanced economies loosened their policy rates. A number of new macro-prudential policies were introduced in a joint move by the Bank, government, and FSS (FSS, 2010; see Table 6.3 for an overview). The central role of financial stability in the conduct of monetary policy was institutionalized prominently in the reform of the Bank Act in 2011 (Article 1(2)), which expanded the Bank's capacity to provide emergency liquidity and put more emphasis on financial stability in the setting of the policy rate (former policymaker C, Seoul, 27 February 2019). Under President Moon Jae-in (since May 2017) from the centrist Democratic Party, housing regulations were tightened again, albeit policy rates have remained low. In October 2018, the FSC introduced the debt service ratio that imposes stricter regulations on high-risk loans to households.

March 2010	loan-to-deposit ratio was introduced in 2010 to improve liquidity of banks
June 2010	Ceiling on Foreign Exchange Derivatives Positions for domestic banks and local branches of foreign banks
October 2010	Leverage Caps on Banks' Foreign Exchange Position
November 2010	withholding tax of 14 percent was reinstated appropriateness to reduce upward pressure on bond prices
July 2011	prohibited financial institutions to buy foreign exchange bonds issued domestically by Korean firms if the issuer is to convert the proceeds into won for local use
August 2011	a macroprudential stability levy was introduced that charges a fee on non-deposit foreign currency liabilities with maturities of less than a year to reduce currency and maturity mismatch

Table 6.3: South Korea's new financial regulations adopted after a spike of international financial inflows

6.3.3 Foreign exchange policy

Foreign exchange policy did not experience significant changes and remained focus on managing the foreign exchange rate by intervening in the foreign exchange markets. The accumulation of foreign reserves continued.

6.4 Conclusion

The case of South Korea lends evidence to the relevance of experts for government strategies to induce institutional and policy change. While for institutional change, experts are mainly instrumental, for policy change they have a certain degree of agency concerning the development of complex policy tools (at least within the wider policy agenda of the government). Institutional change was prepared under Kim Young-sam, propelled by Kim Dae-jung, and deepened under Lee Myung-bak. While this change was perceived by some scholars, particularly neo-institutionalist, as evidence of policy convergence to Western norms, this would ignore the fact that *policies* did not adjust to Western norms.[10] These went beyond expert knowledge provided by Western countries, and focussed on safeguarding the stability of the Korean financial system while continuing developmentalist policies of the past. The case of South Korea thus illustrates the importance of distinguishing institutional change from policy change, as they follow different logics that may coincide (like in the Latin American cases), but do not need to do so. Contributions such as from neo-institutionalist scholars thus are at risk of omitting crucial information for explaining policy outcomes and success of country's management of liberalized financial system. Therefore, gathered empirical evidence lies at odds with contributions in the literature which argue that the 1997 crisis strengthened policy convergence to the Western neoliberal model (Pirie, 2005a, 2012; Kalinowski, 2008; Kim and Lee, 2006) and supports findings from scholars who show how the the Korean state did not give up its control over the financial and economic system but instead transformed its instruments to do so (Thurbon, 2016; Mikheeva, 2019; Park, 2011; Hundt, 2014; Kong, 2012; Kim, 2012g; Chu, 2009; Wong, 2004; Lee and Kim, 2017; Thurbon, 2016; Lim, 2010; Kim, 2005; Thurbon, 2016; Cherry, 2005; Kim and Kwon, 2017; Thurbon and Weiss, 2006; Weiss, 2003; Lee and Kim, 2018).

Previous to the 1997 institutional reforms, the South Korean government used long-term intra-institutional transformation by inserting experts into the bureaucracy and expert commissions to put in place challenging expert knowledge that stood ready to be translated when the 1997 crisis weakened

[10] One former Board member remarked that although central banking looks like it has converged across the globe, country-specific circumstances (economy, society, political system) differences result in diverging policy outcomes (former policymaker A, Seoul, 25 February 2019).

powerful veto players (*chaebols* and Ministry). The IMF served as an additional factor for driving these reforms. This however not so much in terms of setting the agenda for policy change but more in serving as additional leverage for the governments of Kim Young-sam and Kim Dae-jung to overcome structural power of domestic players to policy change they had envisioned via expert commissions in the 1990s.[11] Institutional change since the 1990s followed the governments' objective to curtail the power of the bureaucracy to strengthen their own control over policy outcomes, including by securing the right to appoint key policymakers. Thus the path of policy change is also changed, as experts such as Bank and Ministry careerists lost their stance following these reforms, allowing the government to draw on outsiders (like Kim Choong-soo and Shin Hyun-song) to inform policy change.[12]

Political agency can be identified in the fact that the selection of experts to key policymaking positions was not predetermined. A case in point are the appointments made by Lee Myung-bak, who reversed his original neoliberal policy agenda after the political context changed with the 2007 financial crisis. Instead of appointing neoliberal scholars as could have been expected, he selected the outsiders Shin Hyun-song and Kim Choong-soo mainly based on their international reputation to foster his attempt to establish South Korea as a key player in the reform global financial governance. Beyond their instrumental purpose, experts in policymaking positions propelled the adoption of new financial stability-oriented policies that were established following the 2007 crisis. These policies were directed at reducing risks stemming from international financial flows and maintaining control over liquidity conditions in the domestic financial system. Just because key policymakers like Chon Chol-hwan were fierce advocates of the 1997 institutional change, particularly concerning central bank independence, did not mean they followed Western norms concerning policymaking. Like his successors, he was

[11] Only with the 1997 institutional reforms, the government could increase its leverage over monetary, financial, and foreign exchange policies by appointing experts to head them. It is thus important to distinguish Bank staff and the governors who take policy decisions, between whom frictions have continuously occurred (see for example Park, 2004c; Lee, 2006c). This is a weakness of sociology of knowledge scholars focussing on the role of economists in policymaking without accounting for the dimensions of politics and power.

[12] This does not mean, however, that the power of the bureaucracy was fully dismantled as ongoing tensions between bureaucracies, and the government indicate. Turf wars between Ministry, Bank, FSC, and FSS over jurisdiction over monetary and financial policy have continued also after 1997 reforms (Harald, 2021; KJAD, 2018a, 2016b, 2010e,b, 2008; Chosun, 2003).

convinced that Korea's liberalized financial system requires strong state interventions to prevent speculative international flows to undermine domestic stability.

Expert agency is identified with the analysis of the substance of policies. Due to their complexity they are shaped by experts in key policymaking positions beyond the direct control of the government. Furthermore, the analysis indicates that South Korean expert knowledge does not copy Western expert knowledge. With a strong focus on the production of expert knowledge that accounts for the specificities of the South Korean financial and economic system, it served as a resource to enhance policymaker's capacity to protect financial stability. The undogmatic expert knowledge of policymakers like Chon Chol-hwan or Shin Hyun-song mirror this experience-based expert knowledge - in contrast to academic expert knowledge that has the claim of universal validity as propelled by Sturzenegger or Cavallo in Argentina, the Chicago Boys in Chile or Kuroda in Japan.[13] South Korean policymakers internalized the 1997 crisis experience similar to how their Chilean colleagues were influenced by the 1982 crisis, leading them to account for the inherent instability attached to financial flows that have been largely omitted for in Western economic theories and models.[14] For South Korean policymakers, the development of new policy tools, such as macroprudential policies and international liquidity lines, is considered a "dynamic and continuous process" in the pursuit of protecting the domestic financial system (former policymaker D, Seoul, 27 February 2019). Policies were focussed, similar to Chile, on liquidity management, entailing policies such as the accumulation of foreign exchange reserves, currency interventions, financial policy, and liquidity-focussed monetary policy that also maintained credit policy from the developmentalist period. Similar to Chile, the nationalized debt of the 1997 crisis was securitized and used to promote the development of domestic capital markets which in turn increases independence from global finance.

The case of South Korea illustrates how the production of expert knowl-

[13]Figure 6.2 shows how 'financial stability' was a continuous issue for South Korean policymakers, particular relative to the focus on price stability and inflation, which are core tasks for central banks in Western advanced economies. Figure 6.5 furthermore shows the rise of the keyword 'macroprudential' in governors' speeches of Lee Seong-tae that was strongly pushed in Kim Choong-soo's speeches.

[14] One former policymaker questioned the contribution that "[i]n the financial market, you just make bubble, it's very dangerous in thing" (former policymaker F, Seoul, 4 March 2019).

edge can strengthen domestic agency to manage globalization by developing domestic policy frameworks and by challenging dominant global financial governance that favors rich countries with reserve currencies. It symbolizes a transformation from a country financially dependent on Western countries and the IMF to one that openly criticizes policies of advanced economies and aims at shaping global financial governance. In any case, South Korean governments have maintained the support to the production of expert knowledge adjusted to the specific South Korean situation, perceiving it as a requirement to navigate in a globalized world. This openness and promotion of new ideas was propelled by the Bank reform in 1998 that strengthened the role of research in the central bank (former policymaker A, Seoul, 25 February 2019). Interviews evidence strengthens this awareness that (Western) economic theories cannot be universally applied and have unintended effects that differ across countries (Interview former policymaker A, Seoul, 25 February 2019).

As for the case of Argentina and Chile, also here the analytical focus on the role of expert knowledge in interaction with institutions does not imply that other factors, including interests, do not matter. A further role is played by the strong unions that have raised their voices continuously over issues of central bank independence and appointments to key positions within Bank, FSC, FSS, and commercial banks (Maxfield, 1997, 66,118; Lee and Hong, 2019, 28, 376-7; Cargill, 2001; KJAD, 2003c; KJAD, 2003b; KJAD, 2004; KJAD, 2010f; KJAD, 2016a; KT, 2018). Particularly for decisions concerning appointments and policies, staff members of Bank/FSC/FSS and their unions were a further factor (KT, 2018). As indicated above, the bureaucracy but also *chaebols*, as indicated by their close relations to presidents like Lee Myung-bak and Park Geun-hye, still are important actors that can influence policymaking - but their power to do so decreased with the institutional reforms since the late 1990s.

Scholars interested in central bank independence may object that the government's attempt to influence central bank policymaking was reduced, as illustrated in the fact that no central bank governor was ousted from his position since 1997. Authors like Jayasuriya (2001) make the case of central bank independence in Korea to show how the state gave up control over monetary policy outcomes. However, they leave out that the power of the Bank was curtailed strongly after 1997 as it lost financial regulatory powers. Moreover central bank governors were appointed by the government that head the policy board, thus continuing implicit influence by the president. Further-

more, and this would contradict the assumption that the 1997 institutional change increased de-facto independence of the Bank and the financial regulators, the government did recurrently replace key policymakers: But instead of the the Bank being the target, whose power was curtailed with the reform, this interference occurred in the FSC and FSS, which gained strong control over financial policy in South Korea. Both FSC and FSS became more recurrently under government pressure, with a high frequency of changes of its director (15 for FSC, 13 for FSS). Thus the transfer of financial policy from the powerful Bank to the newly established FSC and FSS did not imply a loosening of state control over the financial system. Instead developmentalist policies were transformed into policies to safeguard domestic financial stability.[15] The implication could be that observed increases in central bank independence also in other cases may be more due to the fact that political influence shifted away from less relevant central banks to more important financial regulators.

[15] An interview partner remarked that banks and financial institutions are still perceived as *public* institutions and are thus continued to be controlled by government, Bank and FSC (Interview, former policymaker E, Seoul, 6 March 2019)

Chapter 7

Japan

The case of Japan's management of its liberalized financial system shows similarities with the trajectory of institutional change in South Korea but diverges to it with regard to observed policy change. Also in Japan, initial financial liberalization under Prime Minister Nakasone Yasuhiro (1982-87) resulted in a prolonged financial crisis that started in 1991. The government of Hashimoto Ryutaro (1996-8) used this crisis to induce institutional reforms that strengthened the government's power vis-à-vis the bureaucracy, which was the driving force and coordinator of economic development during the developmentalist era (1945-1997). Subsequent governments under Koizumi Junichiro (2001-6) and particularly Abe Shinzo (2012-20) used their reinforced power to induce policy change.

As in the case of South Korea, expert knowledge was instrumental for institutional and policy change. Already Nakasone used expert commissions to sideline bureaucracies for propelling policy change. But the attempt by Hashimoto was more consequential as he could make use of the financial crisis in the 1990s and corruption scandals as a moment of weakness of the bureaucracy to push through reforms that were envisioned under his expert commissions. Following these institutional reforms, governments could exert stronger control over policymaking, including by making use of their power to appoint the governor of the Bank of Japan (Bank). For their appointment, governments drew on two traditions of expert knowledge in Japan: structuralism and monetarism.[1] Only when the weak government of Fukuda

[1] Japanese monetarism has similarities to the monetarism advanced by the famous Chicago School, which implies that the quantity of money determines the inflation rate. Japan's monetarist tradition reaches back to Finance Minister Takahashi Korekiyo (1931-

Yasuo did not have sufficient support in the *Diet*, the Japanese parliament, to push through their desired monetarist candidate, a compromise candidate (Shirakawa Masaaki) was selected to become governor from 2008 to 2013. Shirakawa exerted some degree of expert agency to strengthen financial stability-oriented policies, going beyond monetarist and structuralist policy approaches.

Policy change diverged significantly compared to South Korea, following the content of the selected expert knowledge to inform policy change. Japan's policymakers pursued a more thorough dismantling of developmentalist monetary and financial policies in a process initiated under Hashimoto and deepened under Koizumi. As the desired effect of this reform, the return of economic growth, did not materialize, Prime Minister Abe Shinzo (2012-20) used the power acquired by the government after the institutional reforms in the late 1990s to induce significant policy change. While policies until that moment were converging toward Western neoliberal ideals, the subordination of the Bank under the government and the adopted monetarist policies under his Abenomics departed from them.

Two moments of political agency and one moment of expert of agency are analyzed in this chapter. Firstly, the governments of Hashimoto (1996-8) propelled institutional reforms and Koizumi (2001-6) deepened them after the Ministry of Finance was sufficiently weakened. These reforms strengthened control of the government that introduced neoliberal policies, including by handing it power over determining the governor of the Bank. The second moment of political agency occurred under Prime Minister Abe (2013-2020), when he appointed the monetarist Kuroda Haruhiko and reshaped the policy board against resistance from the Bank to become governor in 2013. Massive monetary easing was conducted based on the idea that this would increase inflation and thus economic growth. Thirdly, a moment of expert agency occurred when the compromise candidate Shirakawa became Bank governor, strengthening the Bank's financial stability-oriented policies based on his experience-based expert knowledge.

Following this introduction, Section 7.1 reviews Japanese developmentalist era and its initial financial liberalization in the 1980s that contributed to the financial crises in the 1990s . Next, Section 7.2 analyzes the first moment of political agency, when institutional and policy change was induced under the neoliberal governments of Hashimoto and Koizumi. Subsequently,

6) who initiated purchases of government debt to induce inflation.

	structuralism	financial stability	monetarism
dominance	1997 - 2008	2008 - 2013	since 2013
political support	Hashimoto, Koizumi	compromise	Abe
policy objective	structural reforms, free markets	financial stability	monetary easing, inflation

Table 7.1: Typology of ideas informing policymaking in Japan

the appointment of Shirakawa and his adoption of financial stability-oriented policies is analyzed (Section 7.3). Section 7.4 analyzes how President Abe changed the direction of policies by strengthening the government's grip over the Bank. Section 7.5 concludes.

7.1 Japanese developmentalism (1945-1982) and initial financial liberalization in the 1980s

Similar as in the case of South Korea, Japan's bureaucracy was an influential driver in the developmentalist era (1945-1997). Particularly the Ministry of Finance (Ministry) but also the Ministry of International Trade and Industry and the Ministry of Planning were central actors in studies Japan's rapid economic development (Johnson, 1982; Zysman, 1984). The Bank, which was subordinated to the Ministry, complemented developmentalist policies by allocating cheap credit to targeted sectors in the economy.

The financial system served as the vehicle for providing credit to the real economy and propel economic development. Thus the financial system was strictly controlled by the Ministry, entailing guidance of credit allocation, limits to the entry of new institutions and branches, a compartmentalization of the financial system that limited competition, and heavy restrictions on financial innovations, international capital flows, and interest rates (Teranishi, 1994, 31; Vogel, 1996, 170-1; Aoki and Patrick, 1995). Financial institutions were closely linked to large conglomerates (*keiretsu*) that formed the main bank system, in which lending was based on tight relationships. Bankruptcies did not occur, as the Ministry prevented financial institutions from failing under the so-called *convoy system* (Hoshi and Kashyap, 2001, ch. 3; Lee, 2002, 148-9; Spiegel, 1999).

Although the general direction was set around developmentalist policies, tensions between the Ministry and the Bank regarding the direction of poli-

cymaking were present. Since the 1942 Bank Act revision that subordinated the Bank to the Ministry, the former tried to strengthen its independence from the latter and to pursue policies according to its structuralist expert knowledge, opposing strong state interventions in the financial system (Funabashi, 1989; Werner, 2015; Heckel, 2014; former Japanese policymaker B). Tensions between Bank and Ministry were aimed to be reduced by a rotating right to appoint the governor (*tasukigake jinji*). This power asymmetry between Ministry and Bank changed gradually in the 1980s until mid-1990s that culminated with the institutional reforms in the late 1990s. The government, which had been relatively weak until then, was a driver in this attempt. But more than strengthening the Bank, it was its objective of getting rid of a strong veto player in controlling policymaking and inducing financial liberalization that motivated the government.

In the 1980s, Prime Minister Nakasone (1982-7) aimed at promoting financial liberalization and induce institutional change, following footpaths of Ronald Reagan and Margaret Thatcher (Funabashi, 1989; Hirashima, 2004). The United States, similar like in South Korea, was a facilitating factor for Nakasone's reform attempts. Given the larger size of its economy, Japan was more subject to U.S. pressure than South Korea but faced opposition from domestic veto players in form of the bureaucracy and *kereitsu* (Strange, 1988, 2016; Helleiner, 1996). The United States criticized Japan's low exchange rate policies that benefited its export sector while preventing global investors to invest in the country. To foster a more stable equilibrium in the world economy, the world's leading economies[2] agreed in the Plaza Accord (1985) to induce a depreciation of the US dollar relative to yen and deutsche mark. The Ministry and Bank were in conflict over the question which policies to adopt to meet the objective of rebalancing. The former opposed financial liberalization and supported fiscal austerity and low policy rates to offset foreign exchange imbalances (see Funabashi (1989); Brown (1999)). The Bank in turn was critical of monetary easing and pushed for structural reforms and financial liberalization. The market-friendly Bank was thus a natural ally to Nakasone, and he took advantage of this when he established the Maekawa Commission in 1986 which helped him to sideline the Ministry in the development of policy recommendations (Funabashi, 1989; former Bank policymaker A, Tokyo, 27 March 2019). Maekawa Haruo, the chair of the Commission, left his position as Bank governor just two years

[2]France, Germany, United Kingdom, Japan and United States

earlier before being called by Nakasone to translate the Bank's structuralist ideas into policy recommendations to the government.[3] The Maekawa report developed a blueprint for policy reforms and committed the country to converge to Western neoliberal policy standards (see also Higashi and Lauter (1987)).[4]

Financial liberalization was propelled under Nakasone (see Hoshi and Kashyap, 2001, ch. 7 for an overview). In 1984, a ruling was abolished that restricted firms from engaging in foreign exchange markets to real transactions of goods. Financial institutions were allowed to engage in hedging activities and competition among financial institutions increased, thereby promoting financial activity. Banks were allowed to deal government bonds (1984), the uncollateralized call market and long-term government bonds futures market were established (1985), an offshore market (1986) and a commercial paper market (1987) were created. Trading of Euroyen interest rate futures (1989), government bonds futures options (1990), and Euroyen futures options (1991) followed. The Bank's window guidance was gradually reduced over the 1980s until its official discontinuation in 1991 (Vittas and Cho, 1996; Vittas and Kawaura, 1995; Kato et al., 1994). In the second half of the 1980s, financial inflows spiked. The financial system expanded with a rise of bank lending, market-based financing, and external financing of non-financial corporates (Figures 7.1, 7.2 and 7.3). Financial and non-financial corporations took advantage of new cheap financing possibilities that did not subordinate them to regulations of the Ministry-controlled domestic financial system. Furthermore, due to the international coordination, an appreciated yen (*endaka*) fueled cheap foreign debt inflows that fostered asset price bubbles (see Figures 7.4 and 7.5), while hampering the competitiveness of the export sector (Figure 7.6). Increased uncertainty of lenders was compensated by the request to post collateral (Kunio Okina; Masaaki Shirakawa, 2001, 447). That land was used as a collateral proved to be devastating, as it allowed the expansion of credit during times of price increases of land

[3]The 17 members were Maekawa Haruo, Ohrai Saburo, Tabuchi Setsuya, Akazawa Shinichi, Oyama Hato, Nagaoka Minoru, Ishihara Shun, Kato Hiroshi, Hosomi Taku, Isoda Ichiro, Kosai Yasushi, Miyazaki Isamu, Usami Tadanori, Koyama Goro, Mukaibo Takashi, Okawara Yoshio, Sawabe Mamoru.

[4]Nakasone also established the Commission for Administrative Reform in 1981 and the Administrative Reform Promotion Council in July 1998 to promote policy reforms and strengthen the government's control over the bureaucracy (see (Bevacqua, 1997; Masujima, 2005)).

while it worsened the balance sheets in the economy once land prices were revaluated in the early 1990s (see Figure 7.5). Thus in the late 1980s, over-indebtedness and asset price bubble grew in tandem.

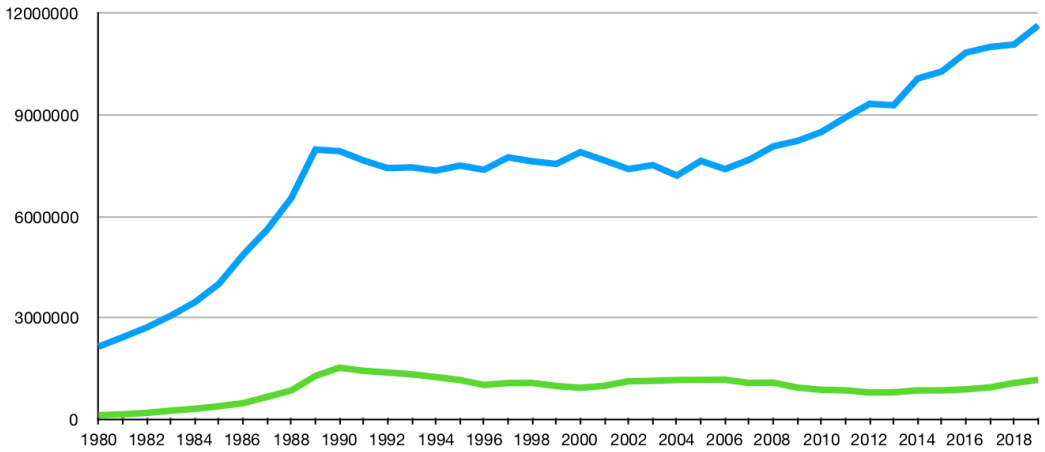

Figure 7.1: Total assets, commercial banks (blue) and non-banks (green) in Japan (JPY 100 million), source: Bank of Japan, Flow of Funds (2008 SNA)

It was only in 1991 that the asset price bubble popped and the financial crises broke out. Unlike in the other cases, it was a domestic actor that triggered the crisis: the Bank. Under Governor and former Ministry bureaucrat Sumita Satoshi, the Bank fueled the bubble since it was pushed to keep interest rates low. When the Bank careerist Mieno Yasushi (governor from 1989 to 1994) took over the position, he decided to increase the policy rate from 3.25 in 1989 to 6 percent in 1991.[5] This triggered the deflation of the asset price bubble. The revaluation of asset prices impaired the balance sheets of financial and non-financial companies as well as households, resulting in bad loans and a reduction of investments which in turn pushed down economic growth and initiated Japan's Great Stagnation. (see also Koo (2013)).

Similar to South Korea in the 1990s, Japan's policymakers missed the adoption of new regulations to control the effects of initial financial liberalization. With international pressure to sustain this policy and an economy that performed well, no changes were made to counter this unsustainable

[5]Until today it remains unclear why Mieno Yasushi decided to increase the policy rate. On the one hand, some suggest that this was a natural reaction to international pressure, others put the focus on the agency exerted by the Bank to provoke a crisis (Werner, 2015).

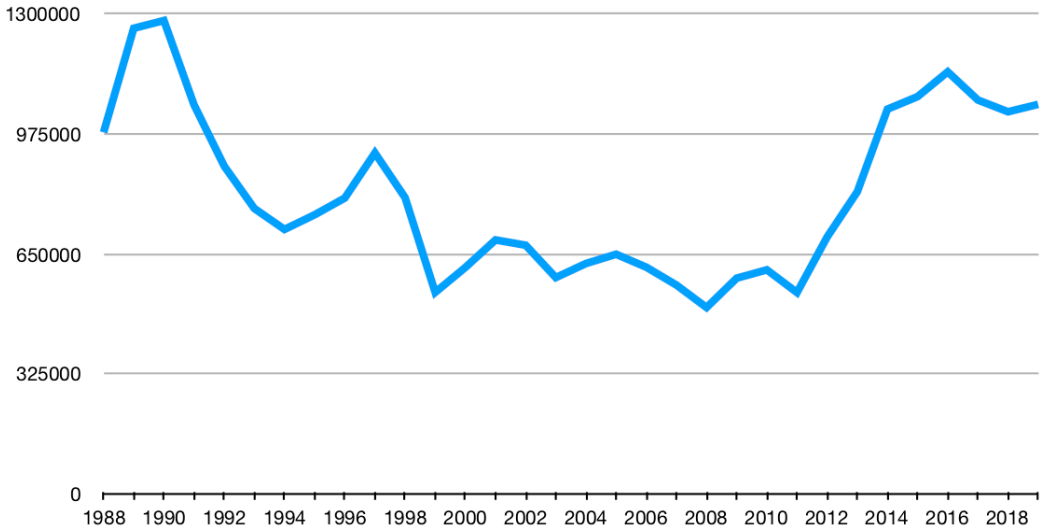

Figure 7.2: External liabilities of domestic banks in Japan (JPY 100 million), source: Bank of Japan Statistics ((Discontinued)BOP (Data Based on the BPM5 [through 2013])/External Assets and Liabilities of Banks, etc.; Balance of Payments (Data Based on the BPM6))

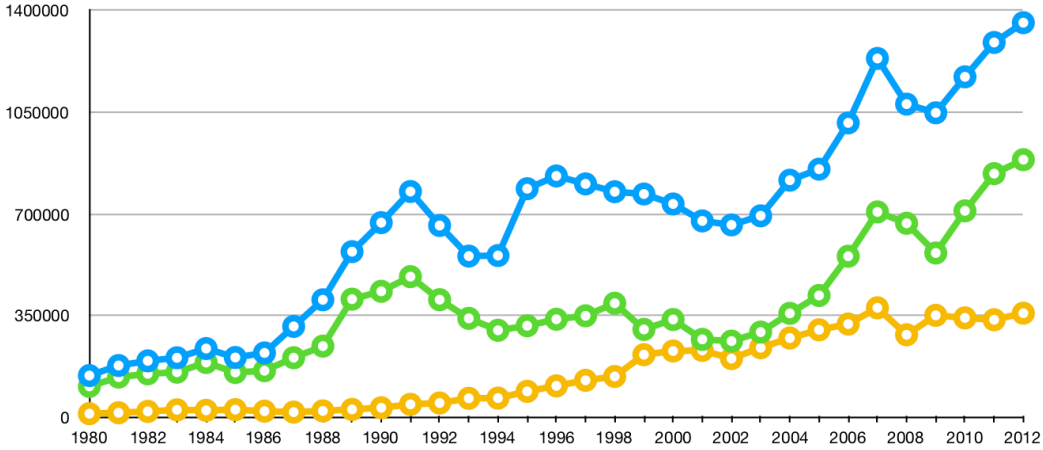

Figure 7.3: Net funding channels of domestic non-financial sector: external financing (blue), debt securities (green), shares and other equities (yellow) (JPY 100 million), source: Bank of Japan Statistics

Figure 7.4: NIKKEI stock index

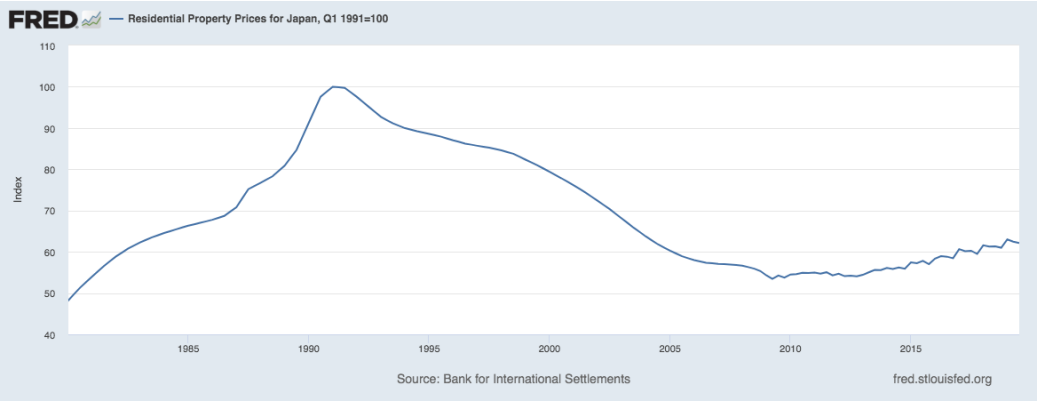

Figure 7.5: Residential property prices in Japan, Index 1991 = 100

situation. Additionally, a lack of experience among Japanese policymakers with a liberalized financial system contributed to the policy failure (Interview Japan expert A, online, 8 May 2020). Relationship-based financial regulation lost its capacity to control financial investments since companies, particularly *kereitsu*, could finance themselves directly on newly liberalized financial markets (Brown, 1999).

Unlike in the case of South Korea, debt restructuring did not occur in the following years and the Ministry instead aimed at preventing failures to occur (*convoy system*). After the bubble bursted, policy rates were lowered. When Mieno's successor Matsushita Yasuo (governor 1994-98) became governor, a careerist from the Ministry, loose monetary policy was deepened,

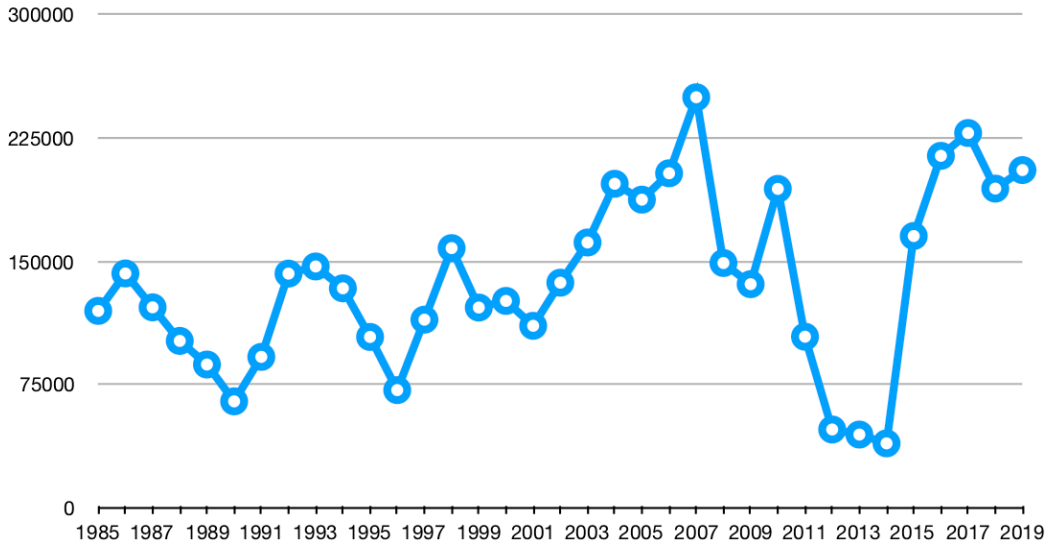

Figure 7.6: Japanese current account, in (JPY 100 million), source: Bank of Japan Statistics ((Discontinued)Current Account (Through Dec. 2001, Provisional); Current account/Net balance)

lowering the policy rate to a historic 0.5 percent by September 1995. The Ministry aimed at providing enough liquidity to prevent failures to occur until the economic situation improves again and the debt problem resolves itself (Metzler, 2008). Subsequently, Japanese policymakers conducted additional liberalization of the financial after the crisis, such as with the loosening of the compartmentalization of the financial system by the Financial System Reform Law in 1992. Particularly the government of Hashimoto (1996-98) aimed to deepen financial liberalization, including by the establishment of asset-backed securities in 1996 and the liberalization of securities derivatives and investment trusts in 1997 (see FSA (2000b)).

However, this time the Ministry's strategy did not succeed in reviving the economy. Instead of resolving the debt problem, the extent of non-performing loans became more and more evident over the 1990s, more than tripling from JPY 12.8 trillion in 1992 up to JPY 43.2 trillion in 2002. It was against the backdrop of this crisis that sufficient pressure built up to overcome domestic opposition to institutional and policy change. Prime Minister Hashimoto (1996-8), similar to Kim Young-sam in South Korea, established new expert commissions to develop blueprints for propelling change. Neoliberal ideas

within the Bank, which emphasized the need to discontinue developmentalist policies and strengthen financial liberalizations, served as source of expert knowledge required to inform these blueprints.

7.2 Hashimoto and Koizumi's neoliberal reforms

Prime ministers Hashimoto (1996-98) and Koizumi (2001-06), both members of the conservative Liberal Democratic Party, were committed to the dismantling of developmentalist policies and the their replacement with neoliberal ones. Symbolic was Hashimoto's plan of a "Japanese Big Bang" that set a schedule of liberalization measures in November 1996, inspired by neoliberal reforms under Thatcher and Reagan(see MoF (1997a); FSA (2000a)). After a period of fiscal expansionary policies under the brief and unstable governments of Obuchi Keizo (1998-2000) and Mori Yoshiro (2000-2001), also both from the Liberal Democratic Party, liberalization measures were deepened under the Koizumi cabinet. Turning away from the manufacturing-centered developmentalist era and going beyond the reform objectives of South Korea, he announced the objective of achieving a "nation founded on financial services" (Koizumi, 2005). A key obstacle targeted by the governments to achieve this objective were the powerful Ministry and the *main bank system*, both core institutions of Japanese developmentalism. At the same time, less government pressure compared to the case of South Korea was directed at the restructuring of the *kereitsu* (Tiberghien, 2007).

Since the beginning of his tenure as prime minister in January 1996, Hashimoto initiated the development of reform plans to change institutions and policies. He saw the crisis of the 1990s as caused by old institutions and structures that need to be quickly resolved. Hashimoto announced that

> *[r]esolving the problem posed by the financial institutions' bad debts is an indispensable prerequisite to rebuilding and restructuring the Japanese economy, and I will make every effort to resolve this issue as quickly as possible* (Hashimoto, 1996)

Instead of continuing to rely on the *convoy system*, Hashimoto requested financial institutions to accept their "unquestionable self-responsibility" in a "high-transparency financial system" (ibid). He considered these as stepping

stones for establishing a market system in Japan that in turn will result in renewed economic development.

To induce this change, Hashimoto saw the need to shift the power balance between the bureaucracy and the government - the bureaucracy needs to be subordinated to the "political will" of government according to Hashimoto:

> *I do not see politics and the bureaucracy as being in conflict. Rather, I see them as cooperative, politicians exercising determined will and leadership for sweeping reforms and the bureaucracy providing the specialist expertise needed to complement this* ***political will*** (Hashimoto, 1996)

Conducive to the preparation of institutional change to establish this new power balance were expert commissions through which the bureaucracy's control over the reform agenda was sidelined. Firstly, Hashimoto established the Administrative Reform Council in November 1996 to develop blueprints for administrative reforms that were adopted in January 2001 (see Bevacqua, 1997; Masujima, 2005; Kaneko, 1999; Mulgan, 2013, 73-4). This Council was filled with academics and business people and did not include any bureaucrat. The objective of these reforms were "to strengthen the administrative leadership of the Cabinet and Prime Minister" (Government, 2001). Secondly, the Financial System Reform Consultative Committee was established in 1996 to develop institutional and policy reforms across multiple policy fields. By the adoption of "bold deregulation measures" it aimed at contributing to "create [...] a system where the market mechanism functions to its full extent and optimal allocation of resources is achieved" (MoF, 1997a). This commission combined efforts of the Ministry's Financial System Research Council, which detailed a list of policy reforms in its final report in June 1997 (see MoF (1997b)), and three other commissions. Thirdly, the Central Bank Study Group, consisting of academics and business people, was founded by Hashimoto in 1996 to develop plans for propelling institutional and policy change concerning the Bank. The report of the Group was then sent to the Financial System Research Council in November 1996, to enact the revision to the Bank Act in April 1998.[6]

These two blueprints aimed at establishing a "free, fair and global" financial system while weakening the power of the Ministry in line with Western

[6]See Heckel (2014) for a detailed description of the negotiations leading to the revision of the Bank Act.

neoliberal norms. Of symbolic value was one of the first decisions taken under this new neoliberal system that discontinued old developmentalist policies: the decision to let financial institutions Yamaichi Securities, Sanyo Securities, and Hokkaido Takushoku Bank go bankrupt in October and November 1997. Hashimoto declared concerning these decision that

> *in the past, we had this strong desire to avoid, as much as possible, any failures of financial institutions, securities houses included [...] We have already made up our mind to reconcile standards with international standards and open up the Japanese market. Therefore, we will not allow the rescue of Yamaichi [...]* ***If we had maintained the past policy, we may have attempted somehow to retain Yamaichi's survival. But, we can no longer do that under the present system*** (Hashimoto, 1997)

As in the case of South Korea, a crisis was used by the government as a convenient moment to overcome domestic resistance to institutional and policy change. When a number of corruption scandals concerning the use of public money to support financial institutions specialized in housing loans (*jusen*) went public over the late 1990s, the Ministry resistance to institutional and policy change envisioned by the government became fragile (see Amyx (2013), WP (1996); NYT (1996); Times (1996); NYT (1998)). Among others, Governor Matsushita and Vice-Governor (and later Governor) Fukui Toshihiko had to leave office over these scandals in 1998. This crisis of the Ministry and its disintegration of its reputation was used by the Hashimoto government to propel the translation of blueprints developed by the expert commissions into institutional and policy change.

A central pillar of Hashimoto reforms were institutional reforms that weakened the Ministry's power over monetary and financial policies, in analogy to changes identified in South Korea. Firstly, the Bank's subordination to the Ministry was discontinued and central bank independence adopted with the revision of the Bank Act in April 1998, in line with Western norms. Nevertheless, two elements of the Act point to divergence to Western neoliberal norms: the government maintained levers of control over the Bank and the Bank maintained tools that allowed it to inject liquidity readily when financial stability is endangered. On the one hand, ministers were not allowed to be board members anymore, only "persons with relevant knowledge and experience including experts on the economy or finance" can be appointed

(Bank Act, Art. 23; see also Han (2016, 131-2)). On the other hand, the government maintained its grip on Bank policies by having the right to appoint the governor, two deputy governors and six further members to the board, with consent by the *Diet* (Bank Act, Art. 23). This change is noteworthy as it discontinues the right of the Ministry to appoint an insider to head the Bank every other time (*tasukigake jinji*). Furthermore, Article 4 (Bank Act) emphasizes that the Bank "shall [...] always maintain close contact with the government and exchange views sufficiently", going beyond coordination mechanisms of Western central banks. Concerning policy tools, the use of liquidity policies to safeguard financials stability was maintained. Special loans (Article 38 and 33) allow the central bank to inject liquidity when financial stability is endangered. Secondly, financial policy was delegated to the newly founded, government-dependent Financial Supervisory Agency in June 1998 (see also Hori (2005, ch. 7)).[7] With the merger with Ministry of Finance's Financial System Planning Bureau in July 2000 and the Financial Reconstruction Commission in January 2001, it was renamed to Financial Services Agency (FSA).

In March 1998, Hashimoto used its new power over the appointment of Bank governors to select Bank traditionalist Hayami Masaru, a fierce advocate for structural reforms and central bank independence who was criticized by politicians and the public for his uncompromising positions (see Dwyer (2012); Hayami, 2003; JT (2003a); WSJ (1999a); WSJ (1999b)). Hayami worked for the Bank from 1947 to 1981, before moving to the private sector and serving as chair of the Japan Association of Corporate Executives. He emphasized the need to propel reform in the corporate sector and deepen them when difficulties appear: Hayami believed that "the most effective and credible prescription to alleviate the pain accompanying structural reforms is to steadily implement reform measures" (Hayami, 2002). This perspective contrasts sharply with his predecessor, Ministry careerist Matsushita, who stated that the Bank's task was to support existing firms until their situation improves (Matsushita, 1997). Hayami's structuralist approach is reflected in the frequent mentioning of 'structure' in speeches during his tenure (Figure 7.9 .

[7] The Securities and Exchange Surveillance Commission, established in July 1992 within the Ministry to supervise securities markets, was integrated into the FSA. The FSA was subordinated to the newly established Financial Reconstruction Commission in December 1998 that was tasked with restoring the financial system, also with the use of public funds.

Koizumi Prime Minister Koizumi (2001-6) deepened institutional policy change initiated by Hashimoto, particularly concerning the development of capital markets and the dismantling of developmentalist public financial institutions. Two expert commission were used by Koizumi to further propel policy change. In April, 2001 the Council for Regulatory Reform, consisting of 15 academics, business people, and consultants, was used by Koizumi to prepare deregulations and financial liberalization. It was a particularly powerful tool for change as it could directly negotiate with the ministries. In its First Report Regarding Promotion of Regulatory Reform from December 2001, further financial deregulation was recommended:

> *We think it will be of critical importance for the development of the national economy to further promote the abolition or relaxation of regulations [...] and through this, to build the bases for the development of the financial services industry,* ***which we think should be one of the future growth industries*** (CRF, 2001)

The second (December 2002) and third report (December 2003) listed further policy recommendation to promote market-based financing, such as the demand to increase attractiveness of bond issuances that were introduced in 1999 (CRF, 2002).

Secondly, Koizumi used the Council on Economic and Fiscal Policy (CEFP) to strengthen control by the government over policy change, guide government budget, and develop recommendations for economic and fiscal policies as well as regulatory reforms. The Council was made up of the prime minister, four ministers, the Bank governor, two businessmen, and two academics and was headed Takenaka Heizo.[8] The CEFP emphasized that its objective was to strengthen control by the prime minister over policymaking, sidelining the Ministry to "fully demonstrat[e] the leadership of the Prime Minister, while reflecting the opinions of private sector experts in policy formation" (CEFP, 2020). Takenaka described the CEFP as a "machine for Koizumi's leadership", considering his own role as "steering the Council to make sure that the Council underpin the prime minister's leadership" (Takenaka, 2002).

Koizumi used the government's right to appoint the governor for shifting the Bank's away from Hayami's structuralism towards more monetary easing

[8]Takenaka was a key figure under Koizumi. He adopted several key policymaking positions, including becoming Minister of the Economy (2001), Minister of Postal Privatization (2005), and director of the FSA (2002).

as both he and Takenaka thought this was necessary to support economic recovery. With Koizumi's appointment of Fukui Toshihiko to succeed Hayami in March 2003 and the subsequent turn away from the Bank's structuralism, the increased leverage of the government over the Bank became more apparent (see Dwyer (2012); JT (2003b)). Aside from the incremental change of monetary policy, Fukui like his predecessor was a proponent of the promotion of financial markets. This included calls for promoting financial innovations, reducing regulations of financial institutions and relying on their risk management techniques instead (Fukui, 2004; Fukui, 2007. Fukui envisioned a "seamless credit provision system, in which customers can get any type of credit" and where risks were self-managed by internal risk management systems (Fukui, 2004).

With the institutional reforms of the late 1990s, the government gained power to induce consequential changes, particularly by dismantling the bureaucracy. As the following sections show, monetary and financial policies were deployed following these institutional reforms to promote the role of the financial system in Japan.[9] Monetary policy was used to accompany the structural adjustment process by providing liquidity to safeguard financial stability. Financial policy included the dissolution of the main bank system, strengthening of market-based financing and the dismantling of public financial institutions.

7.2.1 Monetary policy

While credit policies were already discontinued in 1991 and the Bank's discount window was replaced by the overnight interbanking rate, the main change with Hayami was the use of liquidity policies. With ending the Ministry's *convoy system*, Hayami altered the use of liquidity policies from supporting any financial institution that is at risk of failing towards using it as an instrument for maintaining stability of the financial system at large. This way, the restructuring of the financial system was to be supported without putting its stability at risk.

In November 1997, this new era of monetary policy was anticipated by

[9]Since the conflict with the United States in the 1980s, foreign exchange policy was not actively used anymore beyond the objective of protecting domestic financial stability. As former advisor to Prime Minister Abe stated, the United States has remained highly critical of exchange rate interventions and even threatened to stop negotiations of the Trans-Pacific Partnership free trade agreement over it (see Hamada (2016)).

the political decision not to let the securities firm Yamaichi go bankrupt, a notable break with the old Ministry's *convoy system*. This was followed by the nationalizations of Long-Term Credit Bank of Japan in October 1998 and Nippon Credit Bank in December 1998. To reduce the fallout on the stability of the financial system, the Bank used special loans to inject domestic and foreign liquidity into the financial system. In February 2001, monetary easing was intensified by expanding purchases of government securities while the Bank's liquidity management was further enhanced by the adoption of the Lombard-Style Lending Facility. When stock market volatilities in the early 2000s threatened stability of banks, the Bank began purchasing their stocks (unraveled in 2004). Furthermore, it continued to purchase bills issued by financial institutions, a program that was created in 1998 and transformed in 2006, being renamed to Funds-Supplying Operations against Pooled Collateral.[10]

A gradual shift towards more monetary easing to support economic growth occurred after Koizumi appointed Fukui, who was more attentive towards government concerns than Hayami, to head the Bank in March 2003. While the Bank under Hayami was a opposed to interventions in financial markets by purchasing public and private financial assets (Hayami, 1998; Yamaguchi, 2000; Hayami, 2000; Shinotsuka, 2000), this changed with Fukui's introduction of asset purchase programs: In June 2003, Fukui introduced a purchase program of asset-backed securities, synthetic-type securities and asset-backed commercial paper. This policy had a dual objective of loosening monetary policy and promoting the development of capital markets (BoJ, 2003). By creating facilities to safeguard liquidity of these new financial products, the Bank could strengthen its capacity to maintain financial stability - which later will be copied by policymakers in Western economies during and after the 2007 financial crisis.

7.2.2 Financial policy

Financial regulation The growing amount of non-performing loans from the 1990s reflected that the Ministry's traditional *convoy system* failed to work this time, given a lack of private investment and the Ministry's insufficient financial resources (see Hoshi and Kashyap (2001, 268)). The Bank's

[10]See Olivei (2002) for an overview for a detailed description of the Bank's liquidity instruments at that time.

structuralist position was in direct opposition to the *convoy system*. Instead of injecting more and more liquidity to cover bad assets, the economic and financial system should dismantle developmentalist policies and embrace market discipline, according to the Bank's perspective. Hayami thus pushed for the swift resolution of bad assets, for which the introduction of disclosure requirement of non-performing loans in April 1999 was a cornerstone.

In October 1998, the Financial Function Early Strengthening Law and the Financial Revitalization Law, both shaped by experts of the Industrial Competitiveness Council, were enacted to enhance mechanisms for supporting and resolving troubled banks by injecting public funds. They further established the Financial Reconstruction Commission to manage non-performing loans. The resolution framework was strengthened with the Deposit Insurance Corporation (DIC) Act of 2001. Non-performing loans were purchased by the DIC with the help of public funds and central bank loans. To improve liquidity management, the safety net for banks (Deposit Insurance Corporation, established in 1971) was complemented by one for securities companies (Japan Investor Protection Fund, established December 1998) and one for insurance companies (Life Insurance Policyholders Protection Corporation and Non-Life Insurance Policyholders Protection Corporation, both established in December 1998). In May 2003, the Industrial Revitalization Corporation was founded which supported companies with restructuring processes until its discontinuation in March 2007.

The FSA, headed by Takenaka Heizo, presented several programs to promote the development of capital markets and support SMEs: Program for Structural Reform of Securities Markets (August 2001), Program for Promoting Securities Markets Reform (August 2002), Program for Financial Revival (October 2002), Action Program Concerning Enhancement of Relationship Banking Functions (March 2004), Program for Further Financial Reform - Japan's Challenge: Moving toward a Financial Services Nation (December 2004), and New Action Program (March 2005). These regulatory reforms followed recommendations developed by expert commissions, particularly of the Council for Regulatory Reform, the Council on Economic and Fiscal Policy (see next subsection), and the Industrial Competitiveness Council (Tiberghien, 2007, 133-6). Similar to South Korea, financial inflows were promoted to propel structural change. The financial system was further liberalized with the modifications of the Foreign Exchange Law in April 1998 and the Financial System Reform Law in December 1998, with the objective of breaking close ties between banks and large companies (*main bank sys-*

tem). The compartmentalization of the financial system was weakened by allowing banks to offer insurance products and trade securities by establishing financial holding companies (October 1999). In 2001, over-the-counter sales of investment trusts were established, including exchange-traded funds and real estate investment trusts, and the securities settlement systems was enhanced (2002).

Public financial institutions and institutional investors Both Hashimoto and Koizumi were supporters of structural reforms and pursued a similar policy approach. Koizumi's tenure as prime minister was distinct given his increased pressure on the Bank over monetary policy (see above) and a flagship reform that was left untouched by Hashimoto: the privatization of (developmentalist) public financial institutions. During Japan's developmentalist era, these were key instruments used by the state to extend loans to targeted economic sectors and development projects. Following the Bank's structuralist expert knowledge that was used by Hashimoto and Koizumi to inform reforms with the help of the CEFP, their privatization was considered necessary as otherwise "the market mechanism may not work properly" (Hayami, 2002, also Hayami, 2003, Fukui, 2004). Their dismantling went beyond what the South Korean policymakers did, who transformed their purpose but did not want to give up of this strong tool to control financial markets.

The dismantling of the *postal savings system* over the 2000s was the most important of them. Managing deposits of USD 2.4 trillion in 2001 (more than half of Japan's GDP), it was the largest financial institution in the world. The deposits were channelled to the Ministry, which extended them to the Fiscal Investment and Loan Program (FILP) and the Development Bank of Japan. These in turn invested the funds in different areas, including public corporations and infrastructure projects, according to political preferences. With Koizumi's reforms, the FILP needed to finance itself via financial markets. The Postal Savings Services was discontinued in October 2007, followed by the privatization of the Development Bank of Japan in October 2008.

This reform had also implications for the pension system. The structure of Japan's pension system is complex and includes several different entities in a multi-tier system. The financial assets are massive (total of JPY 376 trillion or USD 3.6 trillion), including those of the largest pension fund in the world (Government Pension Investment Fund, JPY 151 trillion or USD 1.4 trillion). Looking at the investment structure of its assets under man-

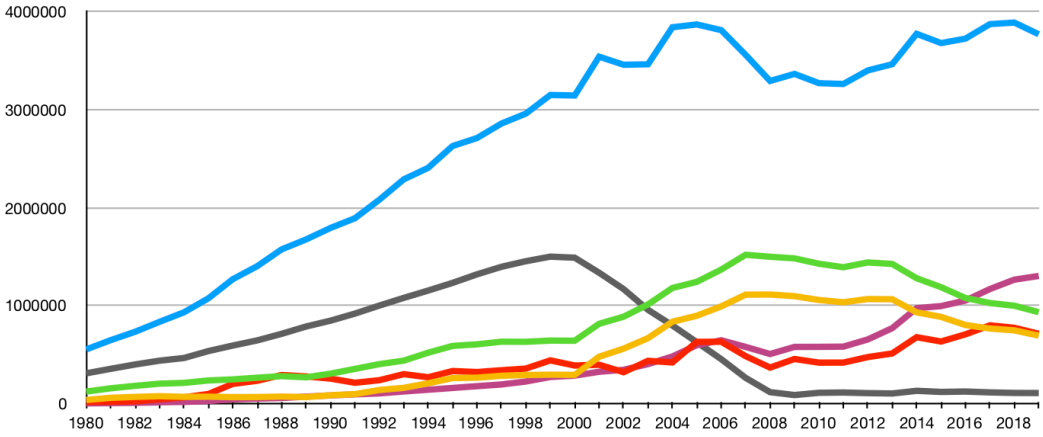

Figure 7.7: Investments of the financial assets of Japan's total pension system (blue), subdivided into Deposits with the Fiscal Loan Fund (grey), debt securities (green) - of which government securities (yellow) -, equity (red) and foreign assets (purple) (JPY 100 million), source: International Monetary Fund, Balance of Payments and International Investment Position Statistics

agement (Figure 7.7), the transformation from developmentalist structures since Koizumi's tenure as prime minister can be observed. Until the early 2000s, about half of all pension system assets were allocated to the Fiscal Loan Fund, with other large position being public and private debt securities and equity. The transition of the phasing out of the FILP over the 2000s was managed by increased purchases of public debt securities that was gradually reduced since the mid 2000s. Simultaneously, foreign investments and equity gained in significance, following the low yields on debt securities in Japan. Similar developments occurred for insurance companies, which are the most important institutional investors next to pension funds (end-2019: JPY 504 trillion (USD 4.9 trillion). Their investments are balanced, almost half of which consist of Japanese public debt securities.

Domestic capital markets The development of domestic capital markets was a key objective for strengthening the role of financial markets and overcome the old *main bank system*. The Bank contributed to the development of domestic capital markets by using two mechanisms. Firstly, Hayami introduced new collateral policies that established asset-backed securities and asset-backed commercial papers as eligible collateral with the explicit objec-

tive to foster market-based financing of corporations (see Hayami, 2003). The Basic Policy on the Eligibility as Collateral of Asset-Backed Securities and Debt Obligations Issued by Financial Institutions that Maintain Current Accounts with Bank in September 1999, and the Guidelines on Eligible Collateral in October 2000 established the Bank's new collateral policy. Continuing the financial policies of his predecessors, the Bank under Fukui emphasized its role for "fixing an impaired financial system and initiating financial market reform" (Hirano, 2006). Governor Fukui perceived that "[asset-backed securities] will be the best candidate to build a bridge from the current bank-centered system to next-generation financial and capital markets" (Fukui, 2003a). Fukui furthermore encouraged financial institutions to adopt financial innovations like collateralized debt obligations, risky derivatives that were at the core of the financial crisis 2007 (see Fukui, 2003c). Secondly, the Bank began purchasing private securities, including asset-backed securities in June 2003 and expand it in May 2004, thus directly contributing to market development by increasing demand (mpo0405a, see also above). Fukui emphasized that "[t]he Bank hopes that the Bank's purchase of securities will contribute to the autonomous development of the market" (Fukui, 2003b).

7.3 Expert agency under compromise governor Shirakawa

For the brief period between 2008 and 2013, against the backdrop of the 2007 financial crisis in Western countries, policymaking shifted from structuralist policies under Hayami and Fukui towards more liquidity-oriented policies directed at safeguarding financial stability. In April 2008, Shirakawa Masaaki, an advocate of financial stability-oriented policies, was appointed by Prime Minister Fukuda Yasuo (2007-8, Liberal Democratic Party) to become the Bank's governor. However his selection was an outcome of a compromise and not of a direct translation of government preferences for expanding government influence over Bank policies. Fukudo, a key alley and former Cabinet Chef for Koizumi, faced opposition from the Democratic Party of Japan, that became strongest party of the Diet's upper house in July 2007 used its power to block unwanted candidates. Fukudo's preferred candidates Muto Toshiro, Koji Tanami, and Watanabe Hiroshi (for deputy governor) were blocked as the opposition criticized that they all worked in in high positions

Governor	Academia	Work
Hayami Masaru 1998-2003	Undergraduate degree (Hitotsubashi University)	Bank (1947-1981); Nissho Iwai Corporation (1981-94); Head of Japan Association of Corporate Executives; chairman of Board of Trustees, Tokyo Women's Christian University (1992-8)
Fukui Toshihiko 2003-8	Law undergraduate (University of Tokyo)	Bank (1957-1998); Fujitsu Research Institute (1998-2001); Japan Association of Corporate Executives (2001-3)
Shirakawa Masaaki 2008-13	Professor School of government, Kyoto University (2006-8); dozens of academic publications; Economics undergraduate (University of Tokyo) and graduate (University of Chicago)	Bank (1972-2006)
Kuroda Haruhiko since 2013	Professor, Hitotsubashi University (2003-5); Law undergraduate (University of Tokyo) and Economics graduate (University of Oxford)	Ministry of Finance (1976-2003) special advisor to Koizumi (2003-5); President Asian Development Bank (2005-13)

Table 7.2: Background of Japan's central bank governors after 1998

in the Ministry before and thus threatened central bank independence (see NYT (2008b); JT (2008a); JT (2008b)). After the position was vacant for three weeks, Shirakawa, a Bank careerist and academic with international experience became the new governor (see Table 7.2).

Unlike in the case of South Korea, Japan's government leader has only limited power to appoint the governor and requires the consent of the Diet. While the structure of Japan's political system thus limited the political agency to induce policy change by appointing the desired expert to key policymaking positions, the case of Shirakawa's tenure at the Bank lends evidence for the role of expert agency in shaping policy substance. This agency was relevant given the specific policy problem at hand, financial instability triggered by panicking investors following the 2007 financial crisis in advanced economies.

The specific expertise of Shirakawa went beyond the Bank's structuralist and Ministry's monetarists traditions. On the one hand, he criticized monetarist policy approaches, questioning that monetary easing will result in more lending and investment, and instead pointing to the risk that this will result in public debt financing by the Bank (see Shirakawa, 2001, 475; Nippon, 2019; Shirakawa, 2012c). On the other, he rejected the structuralist strict focus on price stability, emphasizing that financial stability needs to be established as key policy objective next to it (see Shirakawa, 2010b; Shirakawa, 2009a; Shirakawa, 2010d). His formation was shaped by the crises experiences of the 1990s and Asian financial crisis 1997, which led him to focus on risks attached to a liberalized financial systems and the need to develop new

policies to accommodate these changes that go beyond Western standards of policymaking (see Shirakawa, 2010b; Shirakawa, 2010c; Shirakawa, 2011b; 2011a, Shirakawa). Shirakawa spent most of his career at the Bank, where he began working in 1972, and focussed on issues related to financial stability, asset prices, and bank resolution. In the late 1980s, he wrote a report warning from the rapid increase in asset prices, which was however ignored by his superiors (former Japanese policymaker A). After the bursting of the asset price bubble in the early 1990s, Shirakawa was involved with the resolution of of failing financial institutions and with the development of a resolution framework (Shirakawa, 2009c). In the time of the 1997 Asian financial crisis, Shirakawa stayed at the Bank for International Settlements, which at that time began investing heavily in producing expert knowledge concerning issues of financial stability. Furthermore, Shirakawa has published extensively on monetary policy and the financial system, especially on the asset price bubble and risks to financial stability linked to financial liberalization and easy monetary policy. Before becoming governor, he focussed on academic work during his stay as a university professor at Kyoto University School of Government (2006-8).

Shirakawa considered his formation, particularly his experience of the financial crisis in Japan in the 1990s and Asia in 1997, as central to his policymaking in the 2007 crisis:

> *I[Shirakawa] believe the knowledge and intuition that I gained through this experience has been extremely valuable in making policy decisions in the face of the recent [2007] crisis. Such personal experience has led me to emphasize the importance for people involved in the world of financial stability to have as broad a perspective as possible, rather than confining themselves in a silo* (Shirakawa, 2009c).

Furthermore, he considered that policy changes after the crises of the 1990s and the adoption of liquidity policies in the late 1990s/early 2000s helped to protect the country against the effects of the 2007 crisis (see Shirakawa, 2008a; Shirakawa, 2010b. Similar to South Korean policymakers after 1997, Shirakawa emphasized that policies need to be deployed and continuously updated to prevent financial risks to build up against the background of a volatile and dynamic global financial system, thus contrasting with Hayami and Fukui's positive outlook on the financial system (see Shirakawa, 2008b; Shirakawa, 2009c; Shirakawa, 2009b; Shirakawa, 2009d; Shirakawa, 2009f;

Shirakawa, 2010d; Shirakawa, 2010b; Shirakawa, 2011b; Shirakawa, 2012a; Shirakawa, 2013). The growing relevance of financial stability during Shirakawa's tenure is illustrated by the increase in the frequency of appearances of 'financial stability' in speeches by members of the policy-setting committee (Figure 7.8).

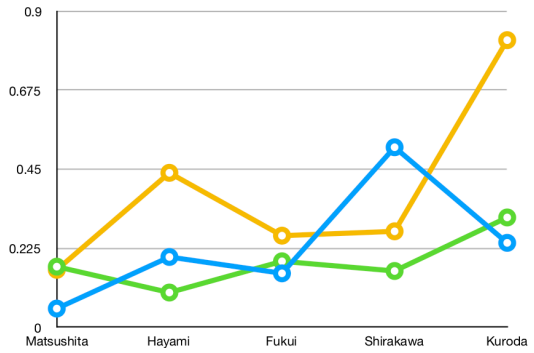

Figure 7.8: Frequency of word occurrence in speeches of policy board members of Japan's central bank, divided into tenures of governors: 'financial stability' (blue), 'price stability' (green), and 'inflation' (yellow).

The following subsections analyze how Shirakawa's distinct policy approach shaped monetary and financial policymaking.

7.3.1 Monetary policy

Japan's economy contracted in 2008/9 due to a fall in demand for Japanese products by crisis-struck Western countries. The stability of the financial system was not directly impaired but Japan experienced volatilities due to panicking Western investors. Policy responses entailed the reduction of the policy rate, liquidity policies, and corporate facilities (Table 7.3). While the former was aimed at stabilizing the economy, the latter two were directed at safeguarding financial stability (see also Mainichi (2018)).

The policy rate was countercyclically used by Shirakawa, lowering it from 0.75 percent in September 2008 to 0.3 percent in December 2018. Following the economic downturn, Shirakawa introduced further monetary easing in October 2010 (Comprehensive Monetary Easing) that entailed more purchases of private assets, including corporate bonds, real estate investment trusts, and exchange-traded funds. However, Shirakawa was wary of poten-

Countercyclical monetary policy	Reductions in the policy rate (February 2007, October 2008, December 2008)
Liquidity policies	Expansion of securities lending facility (October 2008, February 2009)
	Introduction and expansion of US dollar funds-supplying operations; expansion of purchases of Japanese government bonds (September 2008, October 2008, January 2010; expired in February 2010 and re-established in May 2010)
	Introduction of complementary deposit facility (October 2008)
	Expansion of purchases of JGSs (October 2008)
	Liquidity provision for year-end and fiscal year-end (October 2008)
	Increases and expansions of outright purchases of Japanese Government Bonds (December 2008, March 2009)
	Inclusion of Development Bank of Japan as counterparty (December 2008)
	Widening of eligible collateral (securities of real estate investment corporations (January 2009), government-g uaranteed dematerialized commercial paper (February 2009), loans on deeds to public sector (April 2009), government bonds of US, UK, Germany and France (May 2009))
	suspension of bank stock selling program held by Bank
	Resumption of stock purchases held by financial institutions (until April 2010)
Corporate finance policy	Widening of accepted collateral (ABCPs, CPs) (October 2008)
	Increases of commercial paper repo transactions (October 2008)
	Introduction (December 2008) and expansion (February 2009, October 2009) of special funds-supplying operations to facilitate corporate financing (expired March 2010)
	Expansion of eligible corporate debt collateral (December 2008 until end-2010))
	ntroduction (December 2008) and expansion (January 2009, February 2009, October 2009) of outright purchases of commercial paper, corporate bonds and asset-backed securities (expired end-2009)

Table 7.3: Japanese policy responses to 2007 crisis

tial negative effects of this program, recurrently pointed out to risks that purchases of financial assets by the Bank could pose to the financial system (Shirakawa, 2009e; Shirakawa, 2009f; Shirakawa, 2011b; Shirakawa, 2012b).

Liquidity was provided to the financial system in both domestic and foreign currency to safeguard financial stability and ease financing conditions for the corporate sector. Based on the adopted liquidity policies by Hayami and Fukui, the Bank could stabilize the financial system when market volatilities impaired global finance after the failure of Lehman Brothers in September 2008. Having already previously accepted a wide set of financial institutions as counterparties (beyond banks, also securities companies, securities finance companies, *tanshi* companies, the Development Bank of Japan and central counterparties), the Bank could draw on a readymade infrastructure to extend liquidity. Furthermore, number of international swap lines to other central banks were established and expanded (see Table 7.4).

A noteworthy policy change occurred with Shirakawa's introduction of the Loan Support Program, a credit policy-like instrument that resembles South Korea's Aggregate Credit Ceiling and links back to Japan's developmentalist history. Under program, the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth was "introduced as a temporary measure to make the effect of monetary easing permeate the entire economy" in June 2010 (BoJ, 2010b).[11] This followed from Shirakawa's perception, similar to his South Korean colleague Kim Choong-soo, that financial institutions do not extent cheap financing rates to real investments, and instead invest financial resources in the financial system. In June 2012, this was complemented by a program denominated in US dollar (Special Rules for the U.S. Dollar Lending Arrangement to Enhance the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth Conducted through the Loan Support Program). In response to the earthquakes in March 2011 and April 2016, further liquidity

[11] Under this program, the Bank evaluates proposals by financial institutions on how they will lend their received funding to projects in pre-selected areas such as "Medical & nursing care business", "Environment & energy business" or "Science & technology research" that aim at strengthening Japanese growth (see BoJ (2010a)). Eligible are all financial institutions according to Article 37(1) of the Bank Act, which entails banks but also central counterparties for fund transfer transactions, domestic and foreign securities companies, securities finance companies, and counterparties for financial instrument transactions as well as intermediaries in money markets. The Bank subsequently decided on who is eligible for central bank funding, which is currently at 0.1 percent interest.

Australia	March 2016: establishment of currency swap line; March 2019: extension of swap line
Canada	December 2011: establishment of currency swap line October 2013: establishment of standing swap line
Chiang Mai Initiative	May 2000: establishment of a network of bilateral currency swap lines by ASEAN countries (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam), China, Japan, and South Korea December 2009: establishment of a multilateralized swap network between the founding countries and Hong Kong July 2014: expansion of multilateralized swap network
England	December 2011: establishment of currency swap line October 2013: establishment of standing swap line
Eurozone	December 2011: establishment of currency swap line October 2013: establishment of standing swap line
India	June 2008: establishment of currency swap line
Switzerland	December 2011: establishment of currency swap line October 2013: establishment of standing swap line
United States	April 2009: establishment of currency swap line June 2009: extension of swap line January 2010: expiration of swap line May 2010, June 2011, November 2011, December 2012: re-establishment and extension of swap line October 2013: establishment of standing swap line

Table 7.4: International swap lines of the Bank of Japan

was provided by the introduction of Funds-Supplying Operation to Support Financial Institutions in Disaster Areas with the objective of "maintaining the functioning of financial and settlement systems, ensuring the stability of financial markets, and supporting economic activity". With this program, the Bank enhanced liquidity management while strengthening control over credit allocation to discourage speculative investments in the financial system.

7.3.2 Financial policy

Financial regulation Japanese financial institutions were not directly exposed from the financial crisis based on the conservative regulatory framework that was implemented in the late 1990s/early 2000s and limited exposure to toxic financial assets that circulated in financial systems in Western countries (see Harada et al. (2015)). Although Hashimoto and Koizumi aimed at deepening financial markets, including the promotion of financial innovations, there was no market for risky assets like collateralized debt obligation existing, which were at the core of the 2007 financial crisis in Western counties.

Under Shirakawa, the role of global liquidity risk informed policymaking, and Japan was quick in adopting to new Basel III regulatory standards (see Harada et al. (2015)). Sharing a similar background than his colleague Kim Choong-Soo at the Bank of Korea, Shirakawa emphasized the need for strengthening macroprudential policies and was open to the paradigm change envisioned under Lee Myung-bak's G20 meeting in 2010 (see Shirakawa, 2010d; Shirakawa, 2010a). Policy changes in the realm of domestic financial markets and public financial institutions remained subdued. Also foreign exchange policy was left untouched, with the Bank only warning speculators on foreign exchange markets, stating that the Bank "will immediately work with comprehensive countermeasures against the yen appreciation" (Government, 2011).

7.4 Abe's monetarism

While Shirakawa's tenure as governor was successful in terms of preventing financial instability in times of global market volatilities, the 2007 financial crisis in Western countries and the 2011 eurozone crisis pushed down international demand again. Against this background, the Liberal Democratic Party

under Abe Shinzo won the general election in December 2012, replacing the government of the Democratic Party of Japan that led the country since 2009. Abe continued the policies that he pursued during his first brief term as prime minister from September 2006 to September 2008, during which he presented the Economic and Fiscal Reform 2007 Plan that proposed a number of reforms, including the Plan for Enhancing Competitiveness of Financial and Capital Markets from December 2007, with the objective of promoting financial markets development by strengthening decompartmentalization and diversification of exchange traded funds. However, he considered that economic problems were to a large extent due to policy mistakes by the Bank. He particularly criticized the Bank's structuralists resistance to monetary easing, which also Abe considered as capital error. In Abe's first speech of his second tenure, he explains why he thinks that low inflation rates are the most pressing problem for Japan's economy, stating that deflation is a "terrible demon that absconds with people's desire for change" (Abe, 2014).

For his second term, he presented a program with greater aspiration: Abenomics. In January 2013, the government presented the Emergency Economic Measures for The Revitalization of the Japanese Economy that served as a blueprint of subsequent policy measures of Abenomics: easy monetary policy to overcome deflation, reduction of public debt, and the implementation of a growth strategy to improve productivity. Also the objective to promote market development was reinstated, including the "revitalization" of the markets for real estate investment trusts and SME financing. In the same month, the coordination of these policies was presented in a document with the title Joint Statement of the Government and the Bank of Japan on Overcoming Deflation and Achieving Sustainable Economic Growth. It served as the blueprint for their division of labor, and is reviewed annually by the Council on Economic and Fiscal Policy (BoJ, 2013; k130122c) .

The selection of Kuroda Haruhiko to become Bank governor personified Abe's forceful approach. As close allies (Abe served as cabinet secretary, Kuroda as advisor for Koizumi), they followed Koizumi's path of supporting financial liberalization. While also Koizumi favored monetary easing, Abe went far beyond his gradual policy approach. Even tough Abenomics envisioned a balanced coordination of economic policies, monetary policy took the most burden while other policy areas did not experience much change.[12] For

[12]One major policy proposal, the introduction of tax increases as promised by Abe and desired by Kuroda were not implemented, lending evidence to the subordination of the

overcoming resistance to his envisioned policy changes, Abe exerted strong political agency to further weaken Ministry influence as well as subordinate the Bank under the political will of the government - an objective that neither Koizumi nor he during his first tenure as prime minister could achieve. With the fight against low inflation rates as a prime policy objective, Abe did not hide what the role of the Bank and the bureaucracy during his tenure will be:

> We had been unable to root out deflation because Japan had been lacking strong political will. But that is what I have brought to the national leadership: strong political will. **What I would like you to take home from my address today boils down to this single thought: that my economic policies are backed in all respects by my political will** (Abe, 2013)

Abe turned to monetarist experts to inform his policy approach, thus departing from Hashimoto and Koizumi as well as opposing the Bank's structuralism. Unlike structuralists, Abe believed that economic problems can be overcome by substantially strengthening monetary easing. Previous policies such as asset price purchases went in the right direction, according to him, but did not go far enough.

Already his first tenure (2006-2007), Abe was unhappy with the resistance of the Bank to loosen monetary policy (former Japanese policymaker C). What he lacked was a stable majority in the Diet to push through his preferred monetarist candidate. As he achieved this with the 2012 election, Abe could finally reshape the Bank according to his preferences. For inducing this policy change and establish government control over the Bank, Abe appointed Kuroda Haruhiko, a Ministry careerist whose positions are diametrical to the Bank's traditional structuralism, to become Bank governor.[13] Kuroda worked between 1967 and 2003 at the Ministry of Finance, of which he spent the last four years as the Vice Minister of Finance for International Affairs (see Table 7.2). For the first time since Matsushita, a Ministry bureaucrat headed the Bank. This was of strong symbolic value, as it awakened memories of the old rotating principle for the governor's appointment.

Bank to Abe (see NYT (2014)).

[13]Shirakawa resigned in March 2013, one month before his tenure ended, to give space for Abe's pick.

Kuroda promoted the idea that economic problems are based on low inflation rates, which in turn is the responsibility of policy errors by the Bank - the implementation of monetarist theory is necessary to overcome this problem (see 140912a). He stated that he

> *consistently emphasized from an academic viewpoint that the biggest challenge for Japan's economy is to overcome deflation at the earliest possible time and that the role of monetary policy is crucial* (140206a)

According to his monetarist position, "whatever the reason might be, it has been my view that the Bank [...] is responsible for overcoming deflation and achieving price stability" (Kuroda, 2013a; , see also Kuroda, 2013c). Instead of adopting an "incremental approach" like his predecessors did, Kuroda called for "all-out efforts to utilize every possible resource bestowed upon the Bank", including the management of inflation expectations and expansionary monetary policy (Kuroda, 2013b).[14]

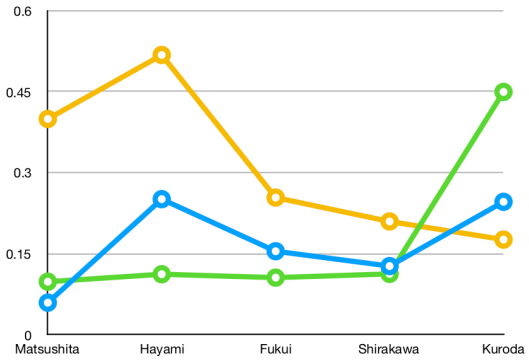

Figure 7.9: Frequency of word occurrence in speeches of policy board members of Japan's central bank, divided into tenures of governors: 'expectation' (green), 'structure' (yellow), and 'deflation' (blue).

While monetarists have been present in the Bank's policy board already previously (such as Nakahara Nobuyuki, a monetarist Bank board member from 1998 to 2001 and a close ally of later prime minister Abe Shinzo

[14]The embracing of monetarists can be traced in the shift of keywords used in the speeches of Bank governors since Matsushita. While 'inflationary expectation' remained relatively an unimportant keyword during his predecessors, this changed during Kuroda's tenure (see Figure 7.9). This is even more the case with the frequency of appearance of the word 'inflation' (see Figure 7.8).

(JT, 2017)), they had been in a minority position since the institutional change of the late 1990s. Abe used his eight years in office[15] and his super majority in the *Diet* for completely exchanging the policy board, replacing structuralist with monetarist-leaning board members that were more open to coordiantion with the government (former Japanese policymaker D): Nakaso Hiroshi (2013), Iwata Kikuo (2013), Harada Yasushi (2015), Nuno Yukitoshi (2015), Sakurai Makoto (2016), Masai Takako (2016), Kataoka Goshi (2017), and Suzuki Hitsohsi (2017).

This decision of appointing Kuroda to head the Bank indicates that the suggested increased independence of the Bank in 1997 lasted only so long as the government supported it. Abe's control over Bank policies was further enhanced by stacking the Bank's policy board with his allies. With the government's increase in control over the Bank and the turn towards monetarism, policy diverged significantly from Western norms. Similar to the case of South Korea, the adoption of institutional reforms that strengthened central bank independence and weakened bureaucracies in the late 1990s did not fulfill expectations of policy convergence. The tenure of Abe serves as a case in point for analyzing how the institutional reform increased the power of the government over policy change.

7.4.1 Monetary policy

Change to monetary policy followed swiftly after Kuroda took office, and the effects in the financial systems were large. While Shirakawa directed monetary policies at safeguarding financial stability, Kuroda shifted their use to achieving inflation and promoting economic growth. In April 2013, Kuroda introduced his Quantitative and Qualitative Monetary Easing, declaring that the Bank will do "whatever is necessary deflation, which has been causing a deterioration in Japan's economy for nearly 15 years" (Kuroda, 2013b). The three pillars were the establishment of a price stability target and forward guidance to anchor inflation expectations; changing of the operating target from overnight call rates (interest rate) to monetary base; and the purchase of Japanese government bonds with all maturities, exchange traded funds (ETFs) and real estate investment trusts (J-REITS). With this, a norm from March 2001 was sidelined that prohibited the Bank from holding more gov-

[15] Abe retained strong public support was re-elected two more times in 2014 and 2017, and gave Kuroda a second tenure in April 2018.

ernment debt than the amount of banknotes in circulation.

Until 2019, government debt stock held by the Bank increased more than 400 percent, stocks of ETFs increased by 2000 percent and J-REITS by 400 percent. Credit policy was adjusted in December 2012, with the Fund-Provisioning Measure to Support Strengthening the Foundations for Economic Growth increasing moderately over time (doubled from 2013 to 2019). Kuroda introduced a related policy instrument (Fund-Provisioning Measure to Stimulate Bank Lending) that reduced the pre-requirements for banks' lending behavior, which increased rapidly from the initial JPY 31,519 million (June 2013) to JPY 410,369 million (end-2019). This facility provides long-term funds low interest rate (0.1 percent interest) "to promoting their aggressive action and helping increase proactive credit demand of firms and households".[16]

While the effect of his monetary policy on financial markets were massive, economic indicators did not show a strong reaction. This did not change when monetary easing was further intensified in gradual steps. In January 2016, Quantitative and Qualitative Monetary Easing with a Negative Interest Rate was introduced. With a slight 5-4 majority in the policy board (all 4 board remembers that were appointed before Abe took office dissented), negative policy rates were introduced, existing programs were expanded and the Bank declared its commitment of overshooting inflation (to exceed 2 precent goal and stay above the target in a stable manner). This was followed by the introduction of Quantitative and Qualitative Monetary Easing with Yield Curve Control in September 2016, which entailed the commitment to overshooting the inflation target as well as extending control from short-term to long-term interest rates. Additionally, credit policies were expanded in February 2014, and January 2015 and asset purchases were expanded in October 2014, December 2015, July 2016, and July 2018.

[16]Eligible for this facility are all financial institutions according to Article 37(1) of the Bank Act, which entails banks but also central counterparties for fund transfer transactions, domestic and foreign securities companies, securities finance companies and central counterparties for financial instrument transactions as well as intermediaries in money markets. The only limit to funding by banks is that it cannot be more than twice as much as increased of their lending.

7.4.2 Financial policy

Financial regulation Although Abe, like Hashimoto and Koizumi, aimed at promoting financial markets, deregulation has remained incremental - there was no ”big bang” like in Argentina and Chile in the 1970s. Financial regulation remained relatively tight, with compartmentalization continued to be comparatively strong and the market for securitized markets small. This has partly been in contrasts to the stark emphasis in the political discourse of the governments. The issue of decompartmentalization is a case in point. Although some reforms where introduced regarding decompartmentalization of the financial system, regulations have remained comparatively strict (Articles 10, 11, 12, 13, 16(2 and 3) of the Banking Act). Foreign banks do not play a role for the Japanese financial system.

Financial stability concerns became more central in Shirakawa's tenure, and was largely maintained under Kuroda. This reflects a wider change in monetary and policymaking after the financial crisis 2007, which put financial stability, like the rise of macroprudential ideas, in a prominent place in debates among central bankers but also politicians. Macroprudential policies are coordinated by FSA and the Bank, and was supported by the foundation of the Council for Cooperation on Financial Stability in June 2014.

Public financial institutions and institutional investors After the substantial dismantling of public financial institutions under Koizumi, no further significant changes occurred under Abe. Institutional investors have maintained their strong influence on domestic capital markets in providing steady demand for debt securities, particularly from the government. Foreign holders of Japan's debt securities amount only to 8.4 percent by end-2019. Thus Japan has remained largely independent from international financial flows, benefiting its control over the stability of the financial system.

Domestic capital markets In November 2013, the FSA established the Panel for Vitalizing Financial and Capital Markets consisting of representatives from academia, business, and finance that was tasked with developing policy recommendations for promoting the development of domestic financial markets. The Council presented its first report in December 2013 and, as a follow-up Further Recommendations for Vitalizing Financial and Capital Markets (June 2014), which focussed on mechanisms to increase attractiveness of companies as investment targets. However, the relevance of market-

based financing has remained low in Japan. While non-financial corporations' financing via capital markets did not increase, this is different for non-banks, which used this new funding source to finance themselves (Figure 7.11). Also bank lending did not increase, instead commercial banks increased their deposits with the Bank. Overall, only public bond markets expanded in Japan while the development of private bond markets stagnated after 1998 (USD 505 bn in 1998; USD 551 bn in 2018). Corporate bonds outstanding slowly grew from USD 368 bn in 1998 to USD 546 bn in 1998 Particularly the asset-backed securities market remained tiny (less than USD 4.0 bn in 2018 compared to USD 2.0 bn in 1998).

7.4.3 Foreign exchange policy

Since 2012, no foreign exchange interventions were conducted by the Bank, and the amount of foreign exchange reserves remained constant. Issues revolving around foreign exchange policy were sidelined, and the benefits of exchange rate management was questioned. Previous foreign exchange interventions remained relatively minor and were conducted in times of financial volatility. Since the official reporting of interventions in 1991, the Bank purchased JPY 787 billion in exchange for US dollar in 1991 to 1992 and December 1997 to June 1998. From 1992 to 2003, US dollar amounting to JPY 67 trillion were purchased and another JPY 16 trillion in 2010 and 2011. These interventions were legitimized by financial instability in these periods, and were not targeted at lowering the value of the yen to promote the domestic export sector. Interventions had the side effect of contributing to a steady increase of foreign exchange reserves over the 2000s to more than USD 1.3 trillion in 2011 that stagnated since then. The massive amounts of foreign exchange reserves (around 25 percent of GDP), combined with low dependency on foreign finance (particularly the distribution of government securities domestically), and relatively conservative financial regulation has limited the exposure of Japan to international financial crises.

7.5 Conclusion

Japan's government under Hashimoto conducted similar institutional reforms like South Korea's Kim Young-sam and Kim Dae-jung to strengthen the control of the government over determining policy change vis-à-vis the bureau-

cracy. They all considered this as a necessary step to overcome old developmentalist structures which, according to them, hindered economic growth. Both Japan and South Korea in the late 1990s are instances where strong political agency was exerted to change the power balance within the state and strengthen control over policymaking. One mechanism of exerting this control was the newly gained right to appoint experts to key policymaking position in central banks and newly established financial regulators. This way the government could exert power over the Bank that it had to share with the Ministry before the 1997 reforms.

As in South Korea, the role of expert commissions was instrumental for governments for inducing institutional and policy change. Given the presence of the powerful bureaucracy, governments relied extensively on expert commissions (such as Nakasone's Maekawa Commission, Hashimoto's Central Bank Study Group, and Koizumi's Council on Economic and Fiscal Policy) to sideline the Ministry and induce change according to their preference. Blueprints for change prepared by the commissions were, like in the case of South Korea, executed by the government at a convenient time in the late 1990s when the reputation of the Ministry was sufficiently weakened, being blamed for the prolonged financial crisis and related corruption scandals.

This chapter showed how the appointment of Bank governors shaped policy change more (Kuroda) or less (Hayami, Shirakawa) according to political preferences. Abe's appointment of the former Ministry careerist Kuroda is a case in point, which has been a strong attempt by the government to subordinate the Bank under Abe's policy agenda (Abenomics). This episode gives strong evidence how the institutional reforms of the late 1990s strengthened government power over controlling policy change by giving it the right to appoint experts to key policymaking positions. Not only was the appointment of a Ministry bureaucrat to become governor a slap in the face of the Bank but the subsequent monetarist policy change directly opposed the Bank's traditional structuralism. Abe could further sustain his control over the Bank as he could, over the course of his three terms in office (2012-20), completely reshape the policy board by replacing structuralists with monetarists. Bank staff was not appointed to board positions anymore with the exception of Amamiya Masayoshi (since March 2018), who was a main figure in the development of monetary easing policies (Reuters, 2012a). Interview evidence lends further evidence to the finding that politicians exert control over the central bank when it becomes political opportune, also after the 1997 reforms (Interview former Bank policymaker C, Tokyo, 27 March 2019; Interview for-

mer Bank policymaker E, Tokyo, 12 March 2019). Simultaneously, central bank governors before Kuroda aimed at weakening bold demands from the government to the Bank (ibid.). Pressure from the government also shaped the behavior of board members critical of the monetarist policy approach (Interview Japan expert B, Tokyo, 11 March 2019).

Beyond the instrumental role of experts, they exerted agency in their own right given the complexity of conducting monetary and financial policy. In the time of a split *Diet*, when political agency was weak, the government could not exert its power to appoint the desired governor. Instead Shirakawa was appointed as a compromise candidate. He navigated between government pressure and his own expert knowledge, which went beyond monetarism and structuralism and resulted in the intensification of financial stability-oriented policies. With his experience-driven expert knowledge, Shirakawa introduced a range of new policy tools to safeguard financial stability that do not fit in either structuralist or monetarist policy approaches.

Similar to South Korea, institutional change of the late 1990s indicate convergence to Western standards. What about the question of policy convergence induced by the government? Governments drew on two different types of existing, traditional expert knowledge to inform policymaking: structuralism and monetarism. Unlike in South Korea, policy did converge to Western norms under Hashimoto and Koizumi and their structuralist governors Hayami and Fukui, entailing price stability-oriented monetary policy, promotion of capital markets, dismantling of public financial institutions, and abstaining from using exchange rate management. However, policy divergence occurred when Shirakawa exerted expert agency and became more pronounced when Kuroda translated monetarist expert knowledge into policies. Although less than in the case of South Korea, expected policy convergence to Western standards following the institutional reforms remained limited.

While monetary policy changed significantly following the empowerment of monetarists, financial policy continued in the same direction, namely to promote the development of financial markets. While both strands expected that economic growth will grow alongside financial markets, this did not materialize. Instead, two major beneficiaries emerged: Financial institutions and the government. The financial system grew massively since Hashimoto (Figures 7.11, and 7.4), particularly in combination with very loose monetary policy under Abe that when flooded the financial system with cheap money instead of enhancing investments in the real economy. Non-financial com-

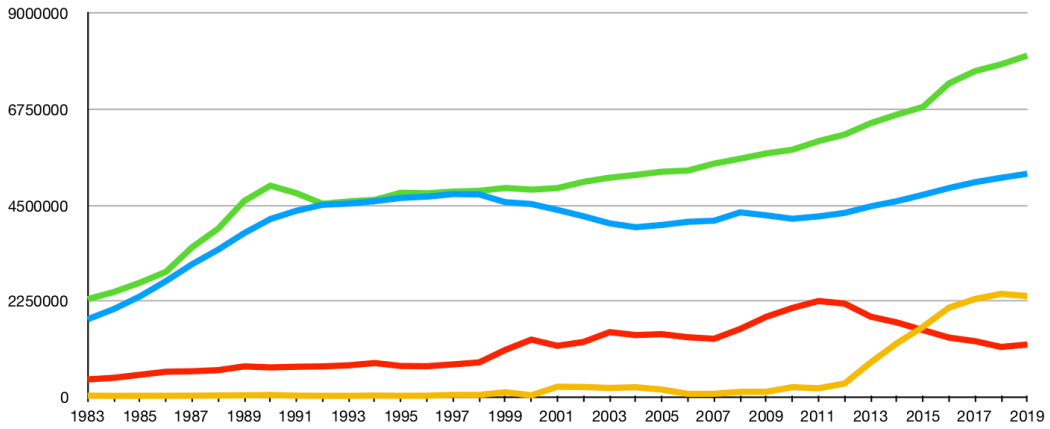

Figure 7.10: Deposits of domestic banks in Japan (green), extended bank loans (blue), bank deposits with the Bank of Japan (yellow), bank debt securities (red) (JPY 100 million), source: Bank of Japan Statistics, Flow of Funds (2008 SNA), Assets and Liabilities of Domestically Licensed Banks(Banking Accounts)(excluding trust subsidiaries and foreign trust banks, through September 1993)(End of Month)

panies hesitated with using capital markets as funding source (Figure 7.11) and commercial banks used their funds increasingly to deposit their money with the Bank (Figure 7.12). The government was the second winner. It could stabilize its financing capacities by the increased purchase of government debt by the Bank, quasi-equivalent to government financing - which is diametrically opposed to Western standards. The Bank's balance sheet expanded rapidly since 2013, reaching the size of Japan's GDP in 2018 (see Figure 7.13), and by end-2019 the Bank owned more than 50 percent of all government securities outstanding (Figure 7.14). Additionally, a large share of the Bank's net income is transferred to the government (Article 53, Bank Law). Due to the increased intensity of asset purchases, the Bank's income increased continuously since the early 2000s, although with volatilities. For the fiscal year 2019, the income reached an all-time high of JPY 1295 billion (USD 13 billion), of which JPY 1230 billion (USD 12 billion) were transferred to the government.

Like in the other three cases, ideas were identified as consequential variable in shaping institutional and policy change. Simultaneously, the effect of ideas is shaped by their interaction with institutions and interests. A

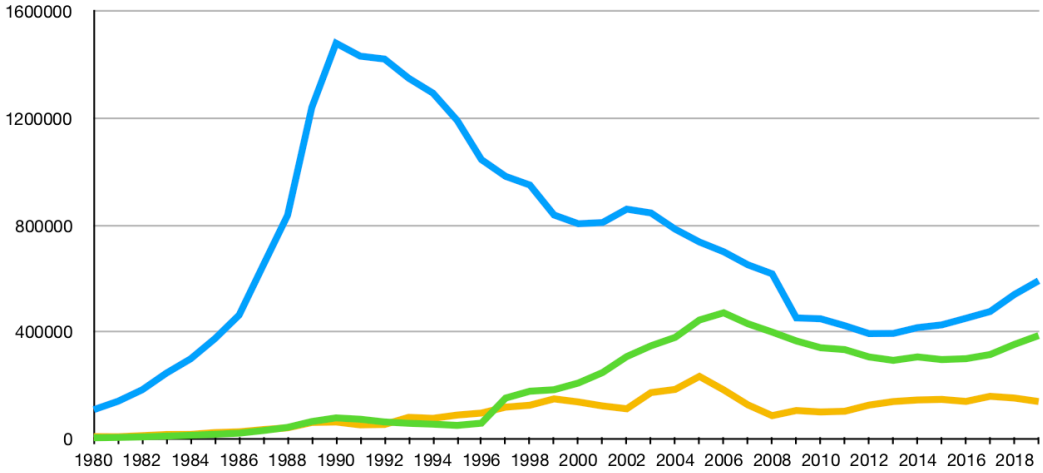

Figure 7.11: Liabilities of Japanese nonbanks: loans (blue), debt securities (green) and equity (yellow) (JPY 100 million), source: Bank of Japan Statistics, Flow of Funds (2008 SNA)

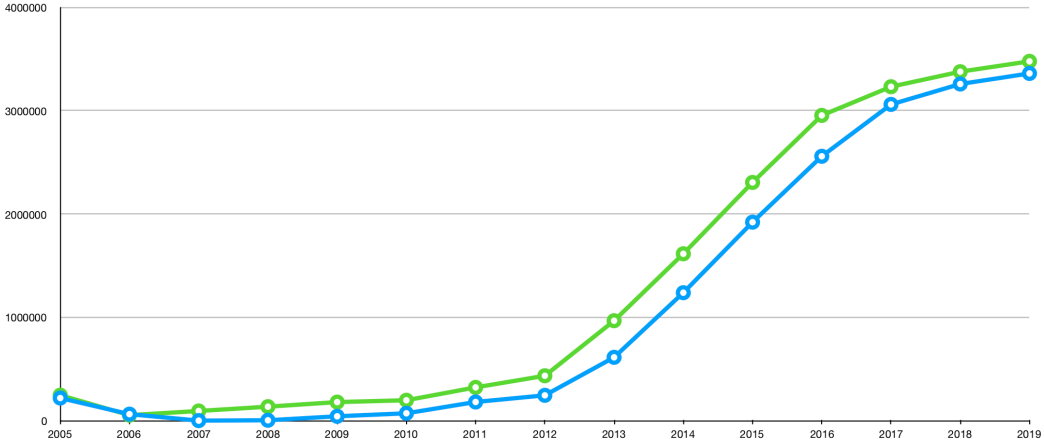

Figure 7.12: Total excess reserves outstanding of Japanese financial institutions (green), of which excess reserves (blue) (JPY 100 million), source: Bank of Japan Statistics, BoJ Current Account Balances by Sector, BoJ Current Account Balances/Subtotal of institutions subject to the reserve requirement/Excess reserves (C-D)/Average amounts outstanding, BOJ Current Account Balances/Subtotal of institutions subject to the reserve requirement (F)/Amounts outstanding at end of month

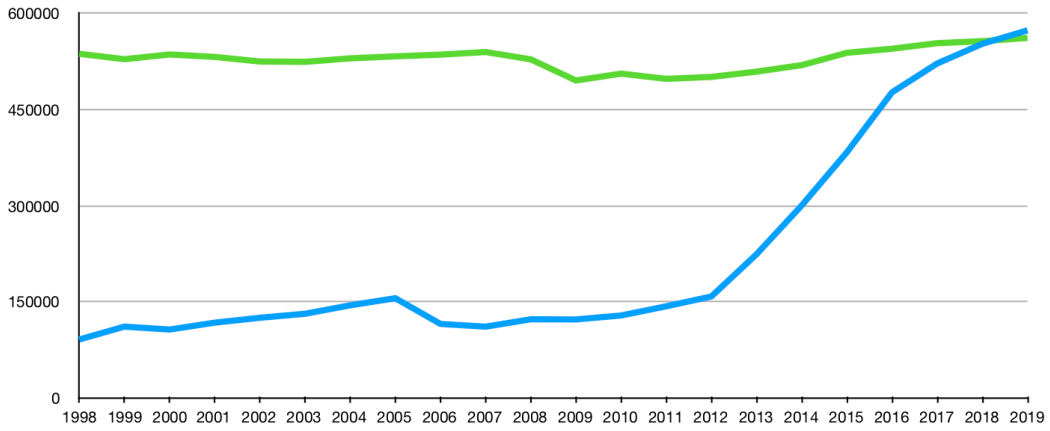

Figure 7.13: Bank of Japan's total assets (blue) and Japan's GDP (green) (JPY trillion), source: Bank of Japan Statistics, Bank of Japan Accounts; Japan's Office, GDP (Expenditure Approach)

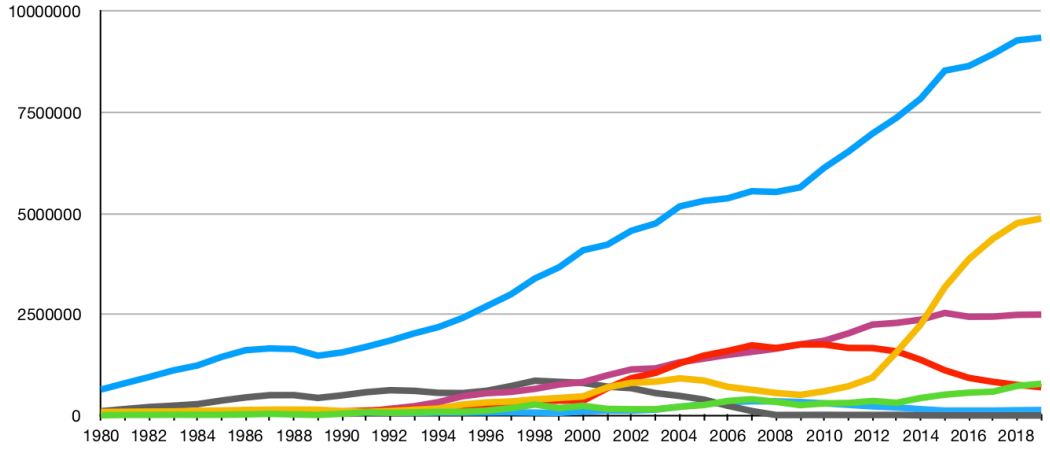

Figure 7.14: Japan's central government securities and FILP bonds (blue), held by foreigners (green), BoJ (yellow), Japan Post and financial institutions for small businesses (red), institutional investors (purple), public financial institutions (light blue) and households (grey) (PY 100 million), source: Bank of Japan Statistics, Flow of Funds (2008 SNA)

number of points illustrate this. Firstly, the Japanese political system is a bicameral parliamentary representative democracy that, in contrast to the presidential systems of the other cases. This power of the Japanese govern-

ment is thus comparatively weak, despite that the party landscape is heavily tilted to the conservative Liberal Democratic Party which, in the post-World War II era, has only been two times in the opposition (1993-4 and 2009-12). This has implications for the appointment process of Bank governors, which requires approval from both houses of the *Diet*. Abe's unsuccessful attempt to induce the Bank to conduct more monetary monetary during his first Cabinet was only successful when his Liberal Democratic Party gained a majority in both houses in 2012. Secondly, the bureaucracy was weakened with the institutional reforms of the late 1990s but continued to be a relevant factor. For example, financial regulation was delegated from the Bank to the newly established Financial Supervisory Agency but the Ministry was able to continue its influence on financial policy by equipping the new organization with own staff (Amyx, 2013; former Japanese policymaker E). Furthermore, prime ministers, including Koizumi, have continued to rely on the support of the bureaucracy to push through policies (see Mulgan (2013, 101-3, 142-4)). Thirdly, interests of the private sector have played a role in the conduct of institutional and policy change. Private interests were generally represented in expert commissions that developed blueprints for reforms. Furthermore, private interests are present in the Bank's policy board. Several board members have had a background in *kereitsu* (Funo Yukitoshi, Nakamura Toyoaki, Morimoto Yoshihisa, Nakamura Kiyoji, Kamezaki Hidetoshi), and finance/banking (Masai Takako, Suzuki Hitoshi, Adachi Seiji, Sato Takehiro, Ishida Koji, Noda Tadao, Mizuno Atsushi), with an increasing tendency under Abe. Furthermore, the *kereitsu* could resist stringent corporate reforms such as in South Korea, while financial institutions at large benefitted from the post-1997 changes, especially under Kuroda's loose monetary policy. However, private interests are insufficient to explain the institutional change of the late 1990s (see Heckel, 2014, 48-9) and do not explain the policy substance of key policymakers. Fourthly, international power, like in South Korea, was more a facilitating factor and less a consequential in itself. Although having adopted similar institutional reforms in the 1990s like South Korea, Japan did was not under direct international pressure as exerted by the IMF. Institutional reforms and policy substance were motivated domestically. International power, however, was consequential in tying the hands of Japan's policymakers in the conduct of foreign exchange management. Since tensions with the U.S. in the 1980s, they restricted interventions to protecting the domestic financial system.

Chapter 8

Conclusion

The thesis has introduced the mechanism *political empowerment of expert knowledge* to complement existing theories that aim at explaining policy divergence and policy change. This political empowerment is conducted by governments that appoint experts to key policymaking positions for the adjustment and adoption of policies. By making use of this mechanism, governments can strengthen state agency to counter convergence pressure in times of globalization. The thesis drew on a nested most-different in most-similar comparative design to test this mechanism. Using the cases of Argentina, Chile, Japan, and South Korea, the results of the empirical chapters lend evidence in favor of the expected causal effect of this mechanism. Thus the presented mechanism enhances explanations for the observed divergence of policy paths following the liberalization of their financial system. At the same time, the analytical chapters took into account that this mechanism does not work in isolation and depends on other factors that have been identified by existing studies on policy divergence, particularly by institutionalist and interest-based accounts. The remainder of the concluding chapter discusses the theoretical and empirical value added by this study as well as political implications that could be derived from it.

The case selection of non-Western countries to study policy change has served as a test of the explanatory power of theories of policy convergence as they tend to argue that Western policy norms spread across the globe. Furthermore, the comparative design served as additional control for the validity of the expected causal link from expert knowledge to policy change across different conditions. Although all four cases liberalized their financial system and therefore increased their susceptibility to convergence mechanisms, this

study found substantial variety in observed policy change. Even though the pairs of Argentina and Chile on the one hand as well as Japan and South Korea on the other do not share a high degree of similarity in contextual variables such as political system or economic structure, in all instances a causal impact of the independent variable (political empowerment of expert knowledge) on the dependent (policy change) was identified. As to Argentina and Chile, both countries pursued import-substituting industrialization until the early 1970s. Their policy paths diverged after initial financial liberalization in the second half of the 1970s that resulted in a massive financial crisis in 1982. In the case of Japan and South Korea, initial financial liberalization occurred in the former in the 1980s and in the latter in the 1990s. Following the liberalization, Japan experienced a prolonged financial crisis after the bursting of the asset price bubble in 1991 while South Korea suffered a global liquidity crisis in 1997.

The empirical chapters showed how the presence of stable values of both dependent and independent variables discontinued following the respective crisis experiences. The occurrences of this new, global liquidity-related type of crisis were used by the governments as critical juncture (Thelen, 1999) to induce policy change, for which the empowerment of expert knowledge played a crucial factor in shaping policy responses. These crises were interpreted differently depending on the type of expert knowledge, inducing divergent policy responses.[1] Thus the most-similar comparison demonstrated how the adoption of different expert knowledge resulted in a diverging policy path of countries that had shared common policy ideas and policymaking until the experience of disruptive financial crises.

Furthermore, the most-different analysis served to show how related types of expert knowledge is causally linked with similar policy change even in cases that did not share commonalities in other relevant factors. After the experience of initial financial crises, governments of both Argentina (during the presidencies of Menem and Macri) and Japan empowered expert knowledge that resulted in the strengthened commitment of policies to promote the further liberalization of financial markets. Liberalization efforts in Argentina went beyond those of Japan, even though reforms such as the privatization of the postal savings system and the Development Bank of Japan in the 2000s were watershed moments to discontinuing Japan's developmentalist policy

[1] As Blyth (2012b) and others discuss, crises are not objectively definable events as such but are needed to be interpreted.

era. In contrast, governments in Chile and South Korea, based on the experience of massive financial crises, empowered expert knowledge that entailed a critical perspective on the functioning and benefits of a liberalized financial system. Both countries adopted and continuously adjusted a range of policies to counter the emergence of financial risks, which especially entail tools to safeguard liquidity conditions that became increasingly fragile due to the exposure to volatile global liquidity. These empirical observations from the most-different comparison lends further support to the argument advanced in this thesis as they indicate how the adoption of similar expert knowledge is linked with the adoption of functionally equivalent policies even against the backdrop of different conditions.

A relevant empirical contribution is the detailed analysis of the substance of policies adopted and adjusted by the four countries to manage their liberalized financial system (see Table 8.1 for an overview). The identified policies indicate that also smaller countries can develop tools to prevent or reduce the impact of crises related to financial liberalization. In Chile and South Korea, the experience of financial crises resulted in the adoption of expert knowledge with a focus on financial stability. A core assumption of this type of expert knowledge was that the financial system requires a range of interlinked policies to reduce the likelihood of financial crises as it otherwise tends to destabilize itself. Policies that reflect this approach entail liquidity-providing and countercyclical monetary policy, financial regulation that delimit risks attached to international financial flows, flexible exchange rate managementto prevent overvaluations and volatile exchange rate movements, public financial institutions that provide liquidity and are used as countercyclical policy instrument, and the development of domestic capital markets that increase independence of volatile international financial flows. These policies contrast with those adopted by governments in Japan and Argentina which empowered expert knowledge that induced an intensification of under-regulated financial liberalization - also after the experience of financial crisis. Financial stability was of secondary concern for these policymakers. The analysis of policy substance helped to demonstrate how ideas are causal in the sense that they informed the development and adjustment of specific policies.

That policies matter for safeguarding financial stability is nothing new. Notably, the gathered evidence indicates that the translation of abstract *academic* knowledge into policies (Argentina, Japan) has fared less well than specific *experience-based* knowledge (Chile, South Korea) in developing and

	Period	Monetary policy	Financial policy			Foreign exchange policy
			Financial regulation	*PFIs and IIs*	*Domestic capital markets*	
Chile	1975 - 1982	procyclical	liberalization	x	x	crawling peg, peg (overvaluation)
	1982 - 1990	countercyclical, liquidity policies	microprud., regulation of internat. finance	countercyclical, promote capital markets	promoted	managed exch. rate (undervaluation)
	since 1990	countercyclical, liquidity policies	microprud., macroprud., regulation of internat. finance	countercyclical	promoted	managed exch. rate
Argentina	1976 - 1983	procyclical	liberalization	x	x	crawling peg (overvaluation)
	1991 - 2001	procyclical	microprud	privatization	x	peg
	2003 - 2007	countercyclical, liquidity policies	microprud., macroprud.	x	x	managed exch. rate (undervaluation)
	2007 - 2013	credit policy, public financing	regulation of internat. finance, public financing	development finance, public financing	promoted	public financing
	2013 - 2019	procyclical	deregulation	privatization	x	liberalization
South Korea	1993 - 1998	countercyclical, credit policy	liberalization	development finance	x	liberalization
	1998 - 2003	countercyclical, liquidity policies, credit policy	microprud., macroprud., regulation of internat. finance	countercyclical, development finance, promote capital markets	promoted	managed exch. rate
	2007 - 2019	countercyclical, liquidity policies, credit policy	microprud., macroprud., regulation of internat. finance	countercyclical, development finance	promoted	managed exch. rate
Japan	1982 - 1990	credit policy, procyclical	gradual liberalization	x	x	appreciation
	1996 - 1998	liquidity policies	liberalization	x	promoted	liberalization
	2001 - 2006	countercyclical	microprud., deregulation	privatization	promoted	liberalized
	2007 - 2008	countercyclical, liquidity policies, credit policy	microprud., macroprud.	x	x	liberalized
	2012 - 2020	countercyclical, public financing, credit policy	microprud., macroprud., deregulation	public financing	promoted	liberalized

Table 8.1: Core features of monetary, financial, and foreign exchange policies in Chile, Argentina, South Korea, and Japan.

adjusting policies to protect the country from financial crises. A case in point is the rejection of South Korea's policymakers to adopt universal, academic theories, as they instead aimed to develop experience-based expert knowledge that is suitable for the specific South Korean circumstances. This ranges from Kim Dae-jung's refusal to accept Western, theory-driven crisis interpretations of the 1997 financial crisis by the IMF to Lee Myung-bak's appointment of Shin Hyun-song and Kim Choong-soo who were appointed as *outsiders* to advance post-2007 policy change. In the Chilean case, Pinochet's replacement of the academic Chicago Boys with pragmatists around Hernán Büchi after the 1982 crisis led to the adoption of a range of policies to control international financial flows. Similarly, Argentina under Néstor Kirchner and Martin Redrado adopted a range of experience-driven policies that do not fit academic theories and helped Argentina to propel economic growth after the 2001 crisis. Also the policies under Governor Shirakawa in Japan such as the adoption of the Fund-Provisioning Measure to Facilitate Strengthening of the Foundations for Economic Growth indicate how experience-based knowledge can help countries to develop policy instruments for overcoming problems.

Focussing on how the empowerment of expert knowledge serves as a source of state agency, the argument of the thesis goes to a certain degree beyond structuralist accounts that encompass interest-based, institutionalist, and ideational explanations. Whereas the focus of the study was put on the causal role of ideas (expert knowledge) in driving policy change, the analytical chapters emphasized how this causal relationship is intermediated by other variables, particularly institutions and interests. Differences in the political and legal system (such as the degree of fractions within the parliament and strength of the bureaucracy) as well as interest groups (such as big conglomerates in East Asia, the agriculture sector in Argentina, and the mining industry in Chile) across the four cases have influenced how these interlinked factors resulted in policy change. For example, the political and legal systems shape to what extent the government has direct control over the appointment of key policymakers (more direct under the presidential democracies of Argentina, Chile, and South Korea than in the parliamentary democracy of Japan). Moreover, central bank staffers were traditionally strong veto players in the appointment process of key policymakers in Japan and South Korea, reflected in informal norms like the rotating principle in the former. While central bank careerists thus regularly took leading positions in these two countries, this is different to the Latin American cases. In Chile,

the policy consensus that emerged after the transition to democracy under the *Concertación* is reflected in the backgrounds of central bank governors, who frequently changed positions in politics, academia, and central bank - there are no substantial frictions between these three spheres. In Argentina, only one (Alejandro Vanoli) out of the last twenty governors pursued a career at the central bank, reflecting the often partisan appointments of the respective president. Differences of these variables are reflected in the academic background and work experience of key policymakers appointed by the governments.

In spite of these constraining factors posed by institutions and interests to induce policy change, the four cases demonstrate how governments could nevertheless often strategically outplay them. Expert commissions were a key mechanisms deployed by governments to sideline the bureaucracy in the development of blueprints and their translation into institutional reforms. The most striking examples are the institutional reforms in Japan and South Korea in the late 1990s, where governments used financial crises as windows of opportunity to strengthen their power over determining policy change vis-à-vis the bureaucracy.[2] This included the government's higher degree of control over appointing key policymakers in the central bank and newly established financial regulatory agencies. Hence even against the backdrop of strong veto players, governments could strategically use institutional reforms to increase their capacity to empower expert knowledge, thus strengthening government control over policy change. Given substantially weaker bureaucracies in the presidential systems of Argentina and Chile, the power of the president to induce policy change was more immediate in these cases. While Chile after the transition to democracy in 1990 pursued policymaking that aimed at balancing out preferences of different interest groups, Argentine presidents often resorted to partisan politics that benefitted core voter groups. Although these contextual variables have affected how governments could induce policy change, in all cases the government used the empowerment of expert knowledge as means for inducing policy change.

Furthermore, the empirical chapters demonstrated how the replacement of the central bank governors and policy board members has served governments to sideline institutional constraints, both legal and organizational ones.

[2]While it was certainly correct to at least partly put the blame for the financial crises on the bureaucracies, it is evident that the governments of Kim Dae-jung and Hashimoto Ryutaro aimed at centralizing the power of the government to overcome political and economic structures that characterized both countries in their developmentalist eras.

While central bank laws are relatively constraining as to which objectives central banks should pursue by which means, they leave sufficient leeway for different interpretations of them by incoming appointees that allow for policy change. Even the strong institutional structures and organizational norms of the Bank of Japan and Bank of Korea could be overcome by this top-down change of the government.[3] Policy change under Abe Shinzo and Kuroda Haruhiko is a case in point: even though it received independence with the 1997 reform of the central bank law, Bank of Japan's policies changed massively according to government preferences. Abe gradually replaced governor and the complete policy board in his tenure from 2012 to 2020, increasing the direct control of the government over the central bank. The collected empirical evidence indicates that expert ideas are not sufficient in itself to have a causal impact - also not if they are located within institutions such as central banks that are presumably highly isolated from day-to-day political influence.

These findings suggest that contributions focussing on policy diffusion miss variegated government preferences as an important factor explaining why specific policy ideas and policies are adopted by governments at certain point in times. Diffusion was propelled when particular ideas, intermediated by expert commissions and research institutions, helped governments to enact institutional reforms and policy change they desired against constraints posed by institutions and interest groups. Thus factors explaining policy translation such as provided by Ban (2016) (ideational legacies, critical junctures, and domestic institutions and international coercion) are at least partially endogenous to government preferences. Furthermore, governments were found not to rely on the adoption of foreign ideas, readily mixing foreign policy or replaced them with domestically produced ones. Taking account of the role of governments in the translation of ideas into domestic policies thus serves to complement existing explanations on the divergence and convergence of policy outcomes.

More generally, the findings have implications for the literature on the role of ideas in policymaking by investigating under which conditions ideas

[3]This is a gap in some of the ideational literature studying policy change. These contributions adopt a micro perspective and presume that ideational change that is found among low-ranking experts within central banks will cause policy change, while sidelining top-down political factors. This thesis's approach acknowledges the relevance of knowledge production on lower levels of institutional hierarchies but emphasizes that expert knowledge needs to be empowered by governments.

matter. While the above mentioned factors shape how direct the government can use empowerment of expert knowledge to induce policy change, *government support* was identified as a necessary condition for ideas to be consequential. In none of the cases the government accepted expert ideas from the central bank or bureaucracy to inform policy directions if they did not suit its preference. While in some cases this resulted in the immediate replacement of central bank governors (Argentina), in others replacements only occurred after the official end of tenures (Japan, South Korea). A different case is Chile, were the policy consensus established by the *Concertación* resulted in a convergence of preference among political parties from the left and the right - thus there has not been a single instance where changing governments led to the empowerment of new expert knowledge.

These findings contrast to empirical findings regarding central bank independence in Europe and North America. Some scholars find that central banks could expand their resources and epistemic investments, thus helping them to gain control over monetary and financial policy issues in respect to the government (Bodea and Higashijima, 2015;Marcussen, 2009; Moran and Williams, 2012; Diessner and Lisi, 2020). Theoretical insights of this perspective cannot explain interventions of Latin American and East Asian governments in independent central banks that were identified in this dissertation. One of possible impediments to studies of cases in Europe and North America that the observed proliferation of central bank independence could be endogenous to government preferences.[4] The gradual change of policy ideas, including the rise of macroprudential ideas, circulating in central banks in Europe and North America as well as in international organization (see Baker, 2013; Ban, 2014; Ban and Patenaude, 2019; Thiemann et al., 2020) did not result in substantial shift of policies (see Johnson et al., 2018; Thiemann, 2018).This argument of this thesis would suggest that more light could be shed on the missing link by accounting for the interaction of ideas with government preference. Recent studies such as by Moschella and Diodati (2019) demonstrate that even in the ECB, considered to be one of the most independent central banks in the world, decision-making in the policy-setting committee are shaped by domestic political interests. Just because

[4]Expectations of what central banks should do according to European and North American norms have been closely linked to their role as 'inflation fighter'. While this perception may hold true in Chile, this is less so for the other cases. Central banks have also been perceived as development banks (Argentina), government banks (Japan), and protector of financial stability (South Korea).

empirical evidence lends support to the central bank independence approach this does not mean that governments would not intervene when it becomes inconvenient to them.

An important question pertains to the motivations of the government to induce policy change. *Why* did governments bring about the observed policy change? In all cases initial financial liberalization was motivated by the desire for inducing large-scale transformation of the economy and society at large. In the cases of Argentina and Chile, financialization was induced by dictators to overcome domestic financial and economic problems. Governments in Japan and South Korea, in contrast, considered financial liberalization as a key factor for overcoming authoritarian developmentalist structures. While thus in the former, large public support of financial liberalization did not exist, the opposite holds true in the latter two.

After the period of initial financial liberalization, political motivations to induce policy change diverges. Rather than explaining the observed institutional reforms and policy outcomes, structural (institutional, ideational, and interest-based) factors that would predict convergence rather act as catalyst to change that is to a certain extent undetermined. This ambiguity of change materializes particularly in times of crises. Different configurations of these explanatory factors lead to diverging outcomes. This dissertation aimed at demonstrating that ambiguity can be used by governments to induce change that accommodates its own preference. Expert knowledge serves governments not only in offering policy proposals to resolve crises but are also instrumental for them to achieve other objectives. What the findings suggest is that although structural factors can circumscribe options of governments, they can use structural pressure to overcome domestic resistance to policy change and institutional reforms. Furthermore, governments can empower domestic expert knowledge to inform policy change.

Transnational epistemic communities (such as IMF, OECD, and BIS) have provided ready-made expert knowledge that presents clear policy paths and institutional reforms. But only in the case of Macri and Sturzenegger in Argentina, a commitment to expert knowledge of these communities can be observed. If it is Büchi in Chile, Chon Chol-hwan in South Korea, or Cavallo and Marcó Del Pont in Argentina, expert knowledge provided by the IMF was only partially adopted and instead domestically produced expert knowledge was used to inform policy responses. And even when some policies and institutional reforms were adopted to accommodate the IMF, other policies

were introduced to offset the effects (such as in South Korea in the late 1990s). Rather the punctual pressure posed by transnational epistemic communities in times of crisis is used as a productive resource for governments to overcome resistance to domestic change.

Similarly international pressure, particularly from the U.S., serves only as an insufficient explanatory factor for government choices, even in times of crises. While this pressure certainly circumscribe governments' choice in shaping policy change and institutional reforms, it does not prevent them from using this external power as a strategic resource for governments to overcome domestic resistance to policy change. These moments in which governments use international pressure to propel domestic policy reforms lends support to the relevance of *vincolo esterno* (Dyson and Featherstone, 1996). This concept unpacks the causal impact of international pressure to show shows how it is used as a strategic resource for governments rather than being a cause for reforms in itself. Empirical evidence that strengthens this insight is found in the cases of South Korea, Japan, and Argentina. While policy change in form of *signaling* to accommodate Western neoliberal norms can be identified in all cases (fitting the neo-institutional argument such as by Maxfield (1997)), this would ignore underlying domestic considerations in adopting reforms. South Korean policy change after its 1997 crisis is a case in point, where the government appeased to Western demands to access IMF funds (in line with a neo-institutionalist approach). Simultaneously, the government enacted institutional reforms that served to strengthen its power vis-à-vis the bureaucracy and enacted reforms that weakened powerful *chaebols*. Similarly, international pressure was used by Japanese governments under Nakasone in the 1980s, Hashimoto in the 1990s, and Koizumi in the 2000s to propel institutional reforms and policy change.

Latin American countries have historically been subject to relatively more direct forms of U.S. pressure, particularly due to their centrality in the Cold War in the 1970s. Given the relative success of Chilean policies to protect the country from financial and economic crises after 1982, international pressure on Chile was relatively low - it could even deploy capital controls in the 1990s to reduce inflows of short-term foreign debt. In Argentina, strong anti-imperialist sentiments reduced the impact of international pressure on domestic policies. Even Cavallo's *Convertibilidad* from the 1990s was initially criticized by the IMF. While thus international pressure pushes government more toward deepening or maintaining a liberalized financial system, it has not been straightjacketing countries that they could not develop and adjust

policies according to own preferences.

It was also found that governments often empowered new expert knowledge because it conveniently fitted their short-term preferences. Rather than committing to existing ideologies, government pursued an *instrumental* use of ideas, ranging from Pinochet's appointment of Hernán Büchi to stabilize his dictatorship in times of public unrest; Menem's promotion of Domingo Cavallo after the failure of preceeding policy experiments; Lee Myung-bak's selection of Kim Choong-soo after his original policy agenda became infeasible after the 2007 financial crisis; to Abe Shinzo's appointment of Kuroda Haruhiko after his predecessors opposed his will. Governments' instrumental approach to expert knowledge is also reflected in the establishment of new research institutions (such as *Fundación Mediterránea* in Argentina or *Corporación de Estudios para Latinoamérica* in Chile) to prepare policy agendas and the appointment of outsiders (such as Büchi in Chile, Redrado in Argentina, Kim Choong-soo in South Korea) to key policy positions. Unlike the literatures on knowledge regimes and transnational epistemic communities suggests, the empowerment of expert knowledge is not structurally predetermined. However, in some instances, the empirical chapters identified government leaders that seem to be *ideologically committed* to certain ideas, thus not using them instrumentally: Cases in point would be Cristina Fernández de Kirchner's developmentalism and Mauricio Macri's neoliberalism in Argentina.

In other instances, governments also followed higher political objectives to which technocratic considerations were subordinated to. A case in point is Chile's *Concertación* which gave up on the implementation of its developmentalist policy blueprints and instead continued Pinochet's policies that were adopted after the 1982 crisis. Although it is likely to assume that Finance Minister Alejandro Foxley believed that developmentalist policies were superior, the government maintained Pinochet's policies to safeguard stability of Chile's political and social system in a period of uncertainty.

The paragraphs above refer to the translation of expert knowledge into policies as well as strategies and motivations of governments to achieve this goal. The focus was thus on *political agency* that is involved in the process of policy change. While it was found that expert knowledge plays a rather instrumental role for politicians, this does not necessary imply that experts do not have any agency. Indeed, experts play a dual role in this process. On the one hand, their appointment follows certain motivations by governments

and their actions once in office is constrained by the government's political agenda. On the other, experts are empowered by governments in shaping policy adjustments. Given the technical complexity involving financial and monetary policymaking, experts are found to exert *expert agency* to the extent that the policies they develop cannot be completely anticipated by the government at the moment of the expert's appointment. This moment of expert agency goes beyond the question of conditions under which ideas matter and puts experts and the knowledge they convey in the spotlight. Examples for this expert agency are Lee Myung-bak's appointment of Shin Hyun-song to translate his macro-financial expert knowledge into macroprudential policies in the early 2010s and Pinochet's appointment of Hernán Büchi to reform the General Banking Law and establish the Central Bank's Basic Constitutional Act in the 1980s. Table 8.1 presents moments of agency identified in the analysis.

This study showed how expert knowledge has differed across the four cases. Beyond the descriptive task to map the existing knowledge types at a certain time and place, further questions entail what are the determinants of knowledge production under which conditions what type of expert knowledge develops. Thus a critical question for a country's agency to counter globalization pressures concerns the production/supply of expert knowledge that is demanded by the government. Only when expert knowledge is produced and stands ready to be translated into policies, it serves as a *convenient* resource for governments to induce policy change. With an increase in supply of expert knowledge, more policy options open up. One strategy pursued by governments (and their oppositions) to promote the production of expert knowledge was the establishment of research institutions (Argentina and Chile) and expert commissions (Japan and South Korea).

Method Another issue that moves to the attention based on the methodological approach of this thesis concerns the adopted methods and the selection of the data sources. Regarding the former, recent methodical developments in the use of text-as-data improved the operationalization of ideas as variable by enhancing quantitative approaches to study ideas. What remains somewhat underemphasized is the development of methods to analyze ideas as independent variable. Thus the analysis of ideas via text analyses does not, in a strict sense, help to strengthen the case for the causal role of ideas. The empirical findings of this dissertation lends further evidence to this some-

	Period	Political agency	Expert agency
Chile	1975 - 1982	reshape Chile, stabilize dictatorship	financial liberalization
	1982 - 1990	stabilize dictatorship	regulation of internat. financial flows
	since 1990	stabilize transition to democracy	x
Argentina	1976 - 1983	reshape Argentina, stabilize dictatorship	financial liberalization
	1991 - 2001	strengthen gov't control	Convertibility
	2003 - 2007	stabilize country	financial regulations
	2007 - 2013	ideology (developmentalism)	demand-led growth, public financing
	2013 - 2019	ideology (neoliberalism)	financial liberalization
South Korea	1993 - 1998	strengthen gov' t vis-à-vis bureaucracy	financial liberalization
	1998 - 2003	strengthen gov' t vis-à-vis bureaucracy	regulation of internat. financial flows
	2007 - 2013	influence on global governance platforms	regulation of internat. financial flows
Japan	1983 - 1987	accommodate U.S. pressure	gradual financial liberalization
	1996 - 1998	strengthen gov' t vis-à-vis bureaucracy	financial liberalization
	2001 - 2006	strengthen gov' t vis-à-vis bureaucracy	financial liberalization
	2007 - 2008	parliamentary compromise	liquidity policies
	2012 - 2020	strengthen gov' t vis-à-vis central bank	monetarism

Table 8.2: Moments of agency in the case studies.

what critical assessment of the turn to text-as-data in social sciences. While text analyses were crucial to identify one part of the independent variable (expert knowledge), it was insufficient to account for the political aspect of the independent variable, which was identified to be a core feature of how different types of expert knowledge are empowered by the government to induce policy change. For deriving conclusions about causality, the conduct of interviews with insiders as well as the analysis of newspaper articles was highly beneficial. Analyses of the political dimension in the empowerment of expert knowledge hence served as a further control to studies that presume the impact of ideas on policymaking without controlling for the political dimension as causal factor.

Regarding the latter aspect of data sources, a tendency in the literature towards the analysis of Western central banks is remarkable. In a superficial approach to assess regional biases of studies that analyze the political economy of central banks, a google scholar search with the combination of keywords "political economy" + "<name of central bank>" was conducted. For <Federal Reserves> 262,000 results were found, for <European Central Bank> 64,100 results, and for <Bundesbank> 28,700 results. On the other hand, only 16,700 results were found for <Bank of Japan>, 6,910 for <Central Bank of Chile> 5,920 for <Bank of Korea>, and 900 for <Central Bank of Argentina>. This indicates a strong bias towards studies of Western central banks. By narrowing down the analyzed universe of cases, there is a risk that varieties of dependent and independent variables are left out.[5] This in turn would limit the generalizability of arguments advanced in the literature. By focussing on non-Western central banks, more variety of ideas and policies can be identified, thus improving existing theories to explain monetary and financial policy.

It needs to be noted that the focus on the empowerment of expert knowledge via the appointment of central bank governors comes with the drawback that other senior officials, such as other policy board members or department heads. While the central bank governor is the most prestigious position in

[5]Hindrances to study non-Western central banks may be due to linguistic accessibility and convenience to access data sources. For example, databases of central bank speeches, like the BIS database, miss speeches of non-Western central banks. This does not only concern speeches in non-English languages but also English-speeches that can only be found on websites of the specific central bank. Thus the development of comprehensive databases of central bank speeches as well as monetary and financial policies could serve to enhance research in the literature.

the central bank and thus serves as a clear sign in which direction the central bank is to move, other senior officials can hinder changes desired by the government. While the government can replace policy board members when their staggered tenures gradually run out, this is different for department heads and lower ranks. They tend to have worked for a longer period for the central bank and are thus more likely to adopt to the specific central bank culture, which are particularly strong in Japan and South Korea. Frictions between politically appointed central bankers on the top and traditionalist in lower ranks can thus appear that might weaken but not cancel out the causal impact of the appointed central bank governor on the policy output.

Political implications Political implications that can be derived from the analysis concern (1) policy substance, (2) production of expert knowledge, and (3) accountability and feedback mechanisms.

(1) Whereas the limited scope of this paper does not warrant for identifying which policies reduce the likelihood of financial crises to occur, it helped to demonstrate that policy substance differs based on different types of expert knowledge. Moreover, the development of financial stability-oriented policies is linked more to experience-based expert knowledge than academic expert knowledge. As experience-based knowledge is more agil and flexible than academic ones, policymaking processes in central banks could be enhanced by making them more reflexive to ongoing changes in the financial system instead of using abstract concepts and models as ubiquitous point of reference. For example, the adoption of financial stability-oriented policies by Chile after 1982 or by South Korea after 1997 was not based on established economic theories and models that did not incorporate financial frictions but instead was directly informed by empirical observations of changes in the financial system.

(2) A possible alley for enhancing state agency in times of globalization is to promote and diversify investments in knowledge production, thus expanding the range of available policy options. The identification of substantial variety in expert knowledge and policies indicates that there is not a single, universal approach to financial and monetary policymaking. State support in promoting the production of different types of expert knowledge within domestic knowledge regimes ~~, including different strands of economic, political science and sociology,~~ could be an important factor in enabling governments to induce policy change that is required to manage effects of a complex, con-

stantly evolving global financial system. Heavy reliance on central banks in developing knowledge could endanger to miss important developments of the financial system due to epistemological limitations of popular economic approaches. For example, central banks' heavy reliance on macroeconomic models that exclude the financial system in informing policymaking before 2007 made them 'blind' to how loose monetary policies fueled the development of financial risks. Diversifying the production of expert knowledge also helps to keep in mind that different policy approaches are possible, and the choice to rely on a specific one is a trade-off that comes with costs. Also the Bank of Japan and Bank of Korea are institutions with a strong, self-enclosed legacy. Only by government interventions (such as by Hashimoto and Abe in Japan or Kim Dae-jung and Lee Myung-bak in South Korea), they could be opened up to external types of expert knowledge. The empirical findings showed how diverse types of expert knowledge contributed to the development and adjustment of policies across Latin America and East Asia. And although the adoption of several financial stability-oriented policies contributed to safeguarding financial stability in the four cases, financial stability became only of relevance to central bankers in Europe and North America after the 2007 crisis. What if they would have been more attentive to expert knowledge outside of their central banks, such as by the warnings concerning financial risks in advanced economies by Raghuram Rajan (IMF Chief-Economist, 2003-7; central bank president of India, 2013-6) directed at his peers at the 2005 Jackson Hole Meeting, the most important yearly get-together of central bankers in the world?

(3) Finally, review mechanisms to improve accountability concerning the empowered expert knowledge may enhance policymaking. Depoliticized, complex policy fields such as central banking (see Marcussen (2009)) are at risk of lacking feedback channels to make adjustment to the empowered expert knowledge and policies derived from it, such as had occurred in Western central banks before the 2007 crisis.

While appointment processes of experts generally encompass parliamentary debate and central bank governors are required to write reports to the parliament, there is a disequilibrium of expertise that makes congressional oversight difficult. Parliaments tend to miss expertise required to assess conduct and outcomes of policies deployed by central bankers. A wider political and social debate about what central banks can and should do in democratic societies seems to be in dire need (see Braun and Downey (2020)).

Non-Western countries, having adopted a range of policies to prevent

the recurrence of financial crises after the experience of crises in the 1980s and 1990s, suffered only a small impact from the 2007 financial crisis and were mostly affected by indirect channels such as rapid financial outflows from panicking global investors and reduced demand from Western countries. Warnings directed to their Western colleagues about risky developments in their financial systems were expressed by prominent policymakers from non-Western countries, including by former governor of the Indian central bank in 2005 in the important "Jackson Hole Meeting" that is annually organized by the U.S. Federal Reserve. Also South Korean governors repeatedly issued warnings to the United States about the buildup of asset price bubbles since 2002, and introduced macroprudential measures to limit asset price increases in South Korea in the mid-2000s to prevent contagion risks. Why did experts in central banks like the Federal Reserve and European Central Bank fail to identify the massive buildup of risks beforehand? Have changes of expert knowledge been sufficient to prevent another expert failure? Evaluation mechanisms could entail international peer review processes that account more from the crisis experiences from non-Western countries and the policies they have adopted to prevent a renewed financial crisis.

There is a major caveat to main conclusion of this thesis, which is that countries (also small ones) have the capacity to deploy agency by developing and adjusting policies to counter effects of globalization: It left out the question of whether and how they can revert trends of financial liberalization. The analyzed policies which were linked to reducing risks of financial crises do not revert financial globalization, but help them to protect a country from its negative effects. By protecting countries, these policies paradoxically stabilize the process of financial liberalization and partly intensify it. Cases in point are the development of domestic capital markets to increase independence from global finance and the use of public financial institutions to invest financial resources abroad to safeguard financial stability instead of making domestic investments to promote economic development.

These policies, thus, are pragmatic in the sense that they reduce country exposure to risks attached to financial liberalization. They thus sideline politically more difficult questions that concern the possibility of revert trends of financialization and the production of inequality both within countries and between economically rich and poor countries. Particularly emerging market and developing economies are structurally disadvantaged in the current global financial and economic system. Attempts to reform global financial

governance such as advanced by South Korea in the G20 meeting in 2010 not only face opposition from powerful Western countries but also lack support from other emerging and developing economies.

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