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1982–91: Indebted Innovation

Your markets are not open to our financial institutions. Your markets are not open to the capital for the rest of the world to enjoy as in the United States market...How much more patience do you want? My response is: action, action, action, that's what I want now. I'm through with patience.

Donald Regan¹

This chapter discusses the period 1982–91, when the US ‘borrowed back much of the credit it had created and exported under the Nixon formula’.² In response to worldwide inflation and interest rate fluctuations, Robert Keohane proclaimed in 1982 that without ‘a dynamic response’, the ‘political-economic future looks bleak for this country [the US], and probably for the other economically advanced, capitalist democracies as well’.³ In international finance, the US provided a dynamic response to politico-economic complexities, though not through the construction of international finance regimes.

To combat economic turbulence of sensitive interest rates, the Debt Crisis and problems with the value of the dollar, Washington and Wall Street promoted direct financing to provide better risk protection and to find innovative means of raising capital and selling debt. Following the Debt Crisis, US banks conducted a ‘search for life beyond lending’ and focused their operations upon financial instruments that were essentially debt securities rather than bank loans.⁴ The promotion of direct financing was in full swing and commercial banks that chose to remain deposit-governed rather than participate in the new investment environment would become antiquated. Competitive pressures upon Britain, Germany, and Japan compelled them to follow suit. Britain rapidly deregulated and formed bilateral ties with the US to promote securities

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trading. Japan began to deregulate its financial system after the 1984 Yen-Dollar Agreement with the US. Germany’s financial system geared itself more towards securities trading under a new national plan, *Finanzplatz Deutschland*, to make Frankfurt the financial center of Europe.

Drawing from their *interactive embeddedness*, Washington and Wall Street were able to extend US structural power in international finance during the 1980s. As in previous decades support for structural power came from both the international and domestic arenas. At home new levels of indebtedness increased the need for financial innovations and embedded finance further into American society, particularly the American middle classes. Ongoing national activism forced intermediaries to compete against each other and to produce innovations in the domestic system that then provided competitive advantages in the international system. The 1980s were thus an era of indebted innovation. Internationally, the extension of US structural power can be seen in continued US reluctance to engage in international regimes. US treatment of regimes reflected the continued use of unilateral and bilateral financial diplomacy. Consequently (and most notably seen in the Basle Accord of 1988), regimes were not used to internalize ‘negative externalities’ but to create positive externalities for US interests. Through canny financial diplomacy, Washington was able to increase the international competitiveness of US intermediaries to promote direct financing and generally increase securities trading for US interests – including the sale of US government debt *en masse* to Japan. Washington assisted Wall Street in enacting change in international finance as well as assuring a market for US debt. This view of the relationship between Washington and Wall Street is not commonly accepted. The 1980s are popularly characterized as a time of further US decline, especially in finance. As a consequence of the shift away from traditional forms of financial intermediation the number of US commercial banks declined during the 1980s. Some scholars in IPE have viewed this decline as an indicator of US hegemonic decline and its need to support regimes. On the contrary, during the 1980s there was a broad shift from loans coordinated through banks to the use of securities markets for capital. This area of finance was clearly dominated by US investment banks and supported by the enormous growth of institutional investors, particularly pensions funds. Commercial banks were not isolated from increased direct financing – indeed, they pushed it forward to increase the flexibility with which they managed their books. Partial financial deregulation in the US supported the promotion of direct financing among all types of intermediaries.