

# **Banking and Financial Systems**

*Catalysts of Social and Political Change*

By

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Banking and Financial Systems: Catalysts of Social and Political Change

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# Introduction

Interconnections between States and banking and financial systems have generally been examined from a number of angles, such as the impact of the financial crisis on the political system, or the impact of elections on the banking system, or the beneficial effects of democracy on business credit conditions (Dinc, 2005). Only rarely does the research examine how the banks' dominance plays a role in determining global politics. On the one hand, governments, through their laws and regulations, significantly influence all facets of business financial operations as well as the economy as a whole. On the other hand, by setting the country's base interest rate – the rate at which banks can borrow money from the central bank – central banks, like the Federal Reserve in the United States, strive to manage the money supply and inflation. All other interest rates established by financial institutions are measured against the base, or prime, interest rate set by the central bank. This suggests that central banks use monetary policy to regulate economic fluctuations and achieve price stability, which leads to low and steady inflation, consequently ensuring the stability of a State. Undoubtedly, the financial and banking system interacts with States through a dual-track system. However, what is becoming increasingly noteworthy is how the banking and financial systems have gained the ability to influence political states and the way of life of the social community. In today's world, banks are seen as significant contributors to solving some of the most pressing societal issues, rather than being seen as their origin. In addition, their social benefits not only aid them in addressing significant issues but also enhance their financial performance. This reality is becoming increasingly evident. Social issues worldwide are becoming more pressing. The effects of Covid-19, ongoing civil unrest, and the continued global economic downturn, have further underscored the belief that growing inequality presents an urgent systemic risk. While governments and businesses mobilize to tackle climate change, it is becoming increasingly apparent that environmental and social issues are deeply interconnected. A planet experiencing overheating is at risk of being unable to facilitate an equitable energy transition, reducing the likelihood of long-term success in climate action.

Due to their pivotal role in society, banks and financial institutions are ideally positioned to wield a significant influence on numerous societal concerns. They play vital roles in the global economy as custodians, allocators, and distributors of capital, directly influencing how well individuals and governments manage their finances and amass wealth. Indeed, banks can assess three key areas of opportunity for driving social impact: their employees, their customers, and the ripple effect created by their customers and business investments. From there, banks can formulate an action plan towards addressing social issues, such as the protection of human rights and climate change, recognizing the interplay between reducing social inequality, and mitigating climate change.

A social case is emerging, paralleling the strong business case for addressing climate change. Consequently, climate change has taken a central role in banks' sustainability strategies in recent years. Regardless of one's judgment regarding the influence of the financial and banking sector on policies and society, it is crucial to examine how often political decisions and societal norms are shaped by undisclosed yet undeniably influential forces. Conventional theories in political, social, and legal studies have explored the concept of power, along with the roles played by state and non-state actors in global politics, as well as how society is influenced by social media in shaping its choices. Similarly, the influence of the financial and banking system has not gone unnoticed in recent academic analyses.

However, the question remains: what type of power do banks and the financial system wield?

The connections between States and private entities in areas that were once thought to be of exclusive interest to States, and within their sphere of influence, demonstrate the rise of non-traditional, non-State actor models in the political and social dimensions, as well as the increasing ability of new forms of private power to directly or indirectly influence State policy. By analysing the theories of Steven Lukes and Susan Strange, this manual goes beyond those theories by asserting that banks and financial centres now act with the same authority traditionally assigned to States. Indeed, while taking into consideration the academic

literature in this field of research, this work will state that banks, with their systems, are now able to play a decisive role in the political dimension, carrying out the main functions of financially supporting States in activities that interfere with international affairs, and/or using their local and global resources to influence and determine States (Tarrow, 2005).

Additionally, after examining the IR theories of power, in particular Joseph Nye's, this thesis demonstrates that banks and financial centres exercise a 'power dependence' on States, according to Richard Emerson's theory (1962). Indeed, States are now increasingly dependent on banks and financial centres. Once the geographic and political barriers in the current globalised system have been eliminated, banks now have more opportunities to engage in international governance and determine States' choices, having a greater impact on both national and international decision-making processes (Ruggie, 2004). Therefore, the questions of whether, and how, the banking and financial system is altering international relations, as well as the State's future role, will be explored.

Furthermore, through an analysis of the influence of the banking and financial system on legal and social matters such as the safeguarding of human rights, as well as the pressing challenges posed by climate change and energy, this study concludes by analysing how banking and financial centres are proactively evaluating their business practices for potentially adverse social impacts in various scenarios.

In the realm of human rights, banks are strategically positioned to increase their societal impact while concurrently improving their business performance. They hold the capacity to revitalize communities, given their ability to harness social opportunities in conjunction with the essential goal of achieving sustainable development for all individuals and communities. When examining climate-related challenges, the intricate and multifaceted nature of social issues makes attaining 'net zero' very difficult, if not unattainable. Nevertheless, banks can assume a pivotal role in addressing these matters, as expounded upon in this manual (Beal et al., 2022).

The case studies of banks involved in State and inter-States policy will be analysed using the theoretical framework presented in this thesis.

The aim of this book is not to single out a specific bank. Rather, the primary objective of this analysis is to demonstrate, based on documented evidence, the emergence of the power structures within the banking and financial systems. These structures, within an interconnected world, have the potential to significantly impact the decisions and actions of states, potentially even challenging their authority.

In a similar vein, this analysis will scrutinize the involvement of banks and financial centres in human rights violations, particularly within the context of the financial sector's engagement in business and environment fields. Another pivotal aspect deserving examination is the interplay between banks and financial centres with the energy industry. Recent research in this domain reveals that global banks allocated a mere 7% of their funding for energy companies towards renewable energy projects and initiatives (Sierra Club, 2023). This level of investment could potentially jeopardize the attainment of the goals set forth in the Paris Agreement.

Presently, there is undeniable evidence that banks and other financial institutions are increasingly focusing on addressing social issues that impact communities. This shift is partly attributed to the emergence of legal mechanisms within the international system that place obligations on banks and financial centres, mandating them to carry out due diligence. For instance, we can take the 2011 UN Principles on Business and Human Rights as a pertinent example.

Undoubtedly, banks and other financial institutions are pivotal in shaping financial and investment decisions. Their core responsibilities lie in financing and investing. However, it's essential to recognize that these functions are far from impartial. They hold the sway to influence state policies, both by justifying their actions and scrutinizing their choices. The financial sector wields a substantial influence on the approach to addressing human rights issues within global corporate value chains, particularly within the realm of investment decision-making. Moreover, banks assume a critical role as investment overseers in the energy sector, a pivotal subject in today's global landscape. Through an examination of these factors, we aim to address the

following questions: has the influence of the financial system evolved beyond merely shaping choices, now potentially extending to impacting policy decisions, societal behaviours, and even opposition to state determinations? In this latter scenario, scholarly inquiries should delve into the modern functions of states, encompassing both their domestic and international dimensions, as well as the entities that wield authority in shaping decisions within societies. So, the pivotal actors – are they the states themselves or the financial institutions and banks?

## **Structure**

This study is organized into distinct chapters and sections. The first part “Banks and Financing System’s Interconnection with States” is an exploration of the intricate relationship between financial institutions (such as banks) and the broader financial system with the governments or States. The first chapter will delve into the significance of examining the role of the banking and financial system in contemporary discourse concerning non-State actors. This exploration will encompass both traditional theories and those that have emerged since the end of the Cold War and the onset of globalization. The sections within this chapter will provide evidence of how the historically consistent relationship between governments, banks, and the financial system has evolved over time. Moreover, it will elucidate the transformation in scholarly perspectives, shifting from a state-centric analysis to an approach centred on the diffusion of power. This shift has expanded the discourse surrounding non-State actors within the global social and political landscape, including the role of banks.

The second chapter will examine how banks now possess capabilities equivalent to those of nation-States in shaping the global political agenda. This chapter will delve into a case study involving BNP Paribas and its role in the Sudan war, providing a comprehensive analysis. Taking into account established research theories that form the theoretical underpinning of this thesis, the sections within this chapter will articulate the type of influence wielded by banks and financial centres in the social and political sphere, as

well as the evolving role of nation-States in this context.

In a parallel manner, the second part, entitled “Banks and Financing Systems’ Interconnection with Environmental, Social and Human Rights” refers to the intricate relationship between financial institutions and banks and the broader financial systems, with considerations related to environmental sustainability, social impact, and human rights. This involves evaluating the impact of financial decisions on the natural world, communities, and individuals, and understanding how financial institutions can align their operations with ethical, sustainable, and socially responsible principles. It underscores the need for a holistic approach to finance that takes into account not only economic considerations, but also the broader implications for the environment, society, and human rights. The third chapter will scrutinize the roles played by banks and financial institutions in the realms of human rights and business, climate change, and energy. These chapters will thoroughly explore the multifaceted ways in which these financial entities have risen as influential agents in crafting policies, influencing societal behaviour, and catalysing change, in response to pressing human rights and climate concerns. Employing a comprehensive examination of case studies, theoretical models, and policy strategies, the analysis will emphasize the dynamic transformations taking place, and delve into their implications for forthcoming policy formulation and global cooperation.

The fourth chapter, contained in this part, will delve into the ethical aspects of banking and financing systems. This chapter aims to explore the ethical considerations and principles that underpin the operations and practices within the realm of financial institutions. It will scrutinize how banking entities integrate ethical standards into their decision-making processes, risk management strategies, and overall conduct. Within the context of the financial landscape, ethical considerations encompass a broad spectrum of issues, including transparency, accountability, fair lending practices, responsible investment, and adherence to regulatory frameworks. The chapter will explore how banking institutions navigate the delicate balance between profit maximisation and ethical responsibility.

## Methodology

The methodology employed in this book aims to systematically investigate the diverse roles played by financial entities in influencing policies, societal behaviour, and driving change in the context of pressing human rights and climate concerns. This research encompasses a multi-disciplinary approach, combining qualitative and quantitative methods to provide a comprehensive understanding of the intricate dynamics at play. An extensive review of academic literature, policy reports, case studies, and theoretical frameworks related to the influence of financial entities on human rights and climate change issues is on the basis of this work. Moreover, the analysis will consider relevant case studies that exemplify instances where financial entities have played a significant role in shaping policies related to human rights and climate concerns. Utilizing a blend of qualitative and quantitative methods, this study places a strong emphasis on the examined case studies, incorporating theoretical frameworks and their practical application in real-world contexts.

In this work, critical discourse analysis is employed. Various databases and search terms, including 'banking', 'financial systems', and 'power', were employed for the literature review. It is important to note that this study uses the terms 'bank' and 'financial services' interchangeably when referring to language. Even so, it is acknowledged that there are some key differences between the two. Banks are financial institutions that are authorised to offer loan products and accept deposits, despite the fact that the financial industry as a whole comprises a huge range of economic entities, including retirement and investment businesses, mortgage brokers, and banks. Banking is therefore a part of the financial services industry, even though not all bank services fall within the formal definition of financial services.

This work draws on citations and references from previous research studies, providing the theoretical foundation for the current investigation and serving as the basis for the literature review in this thesis. While there have been prior studies on the specific subject of this thesis, it requires further development. Consequently, this handbook endeavours to establish a new typology of research, highlighting the need for continued growth in this field of study.

## PART 1

# The Interconnection of Banks and Financial Systems with States

## Chapter 1

# Banking and Financial Systems: A Topic in the Debate on the Role of State and Non-State Actors

### **Section One: The banking and the financial system in social and political contexts**

Governments and banks have had long-standing partnerships in the past. Consider the Medici Bank, which had locations in Rome, Venice, Lyons, Bruges, and London. By providing financial support for their endeavours, they built contacts with the sovereigns and the great European nobles. Talking about the Bank of England at the turn of the 18<sup>th</sup> century, Adam Smith (1776) claimed that “The stability of the Bank of England is equal to that of the British Government [...]”.

Also, consider the cash provided by German bankers to revolutionary Russia in more recent times. Alexander Parvus, a contentious character in the Revolution, persuaded the German empire’s financiers to provide funding for the uprisings against the monarchy (O’Brian and Palma, 2016). Or consider Bendix Aviation, which was owned by Morgan Bank and delivered many aircraft engines to Germany between 1934 and 1935, or American financial institutions like Chase Bank, which provided nearly US\$20 million in financing for Nazi Germany between the years 1936 and 1941 by selling Rueckwanderer Marks to US nationals of German ancestry. Finally, consider also how banks were crucial in establishing diplomatic ties between the ‘old continent’ and the United States (US) following the Second World War. At the time, European countries needed to rebuild their reputation as trustworthy partners with the US: in this regard, European countries’ banks encouraged US financial institutions to invest in their homeland markets, with positive outcomes for Europe (Churchill, 1948-1953).

The facts just mentioned show that historically, banks have always played an important role in the political and social framework. Banks at that time assisted States in influencing them. However, they worked for sovereign governments that continued to play a major role in international relations.

Have banks' and financial centres' relationships altered over time? According to Kal Holsti (1998), considering the current period of significant change, the definition of the global political system as being anchored to the way States relate to one another is a constrained conceptual construction. The interactions between States and the banking and financial systems, which have evolved in response to new phenomena, such as globalisation and technical transformation, are among the most significant changes currently occurring.

One of the features of the current situation, long ignored by both political and economic theory, is the technical transformation, which, has more than anything else, contributed to the change in power structures (Stopford and Strange, 1991).

The international system has undergone significant transformation in the last 25 years. This includes the shift from a bipolar world order to a new, evolving one, a redefined role for the US in global affairs, the emergence of new centres of power, the dispersion of influence among a range of State and non-State actors, ongoing regional integration efforts, the increasing prominence of leading developing nations in the global economy and politics, a resurgence of ideological conflicts and a competition between different models of development, the surge of nationalism, and the emergence of new security challenges, including terrorism and extremism. The processes of globalisation and the rapid pace of technological advancement which characterise the current era have accelerated these transitions to an unprecedented degree.

Indeed, the aftermath of significant conflicts has consistently resulted in profound shifts in the global order across both historical and modern epochs. Indeed, this pattern of transformative epochs can be illustrated by pivotal milestones. The Westphalia international system, established

between 1618–1648, serves as a prime example. Subsequently, the 19<sup>th</sup> century saw the rise of the Vienna System, following the triumph of the Allies over Napoleon. The aftermath of World War I delineated the parameters of the Versailles-Washington System. Likewise, the post-World War II period witnessed the creation of the Yalta System, wielding a similar influence in shaping the global landscape.

The late 1980s saw the initiation of contemporary transformations, catalysed by Gorbachev's reforms and his 'new thinking' policy. This approach helped ease ideological, political, and military tensions between the opposing camps of socialism and liberal democracy. Consequently, it led to the end of the Cold War and a significant decrease in the risk of nuclear conflict. The rapid dissolution of the USSR and the wider socialist bloc was deeply impacted by these changes. Consequently, the global power structure transitioned from bipolarity to unipolarity and eventually to multipolarity. The relatively brief era of American dominance, historically speaking, came to an end. The collapse of the USSR fundamentally altered the geopolitical landscape. Many nations in the global South, facing the loss of their patrons, sought new strategies for survival. A majority of them perceived American influence and Western political and cultural values as a threat to their own beliefs and ways of life, leading them to reject it. These sentiments gave rise to factions whose disruptive actions significantly influenced subsequent developments in the post-Cold War international system. In contrast to its earlier iterations, the current multipolar world order exhibited greater volatility and unpredictability.

A dramatic acceleration of globalisation has accompanied recent changes on the international stage. The conclusion of the Cold War and a technological revolution in communication, enabling swift movement of people, capital, information, technology, ideas, and goods across international borders and around the world, are intricately intertwined with this phenomenon. Globalisation has resulted in a substantial rise in worldwide interdependence and interconnectedness, fortifying ties between different nations. Moreover, new non-State actors, harnessing technological advancements, have started to play a significant role

alongside states in global affairs. In the post-war decades, and for much of the Cold War, technology was driven and directed by States. In the 1990s, it began to be led and directed by the private sector, including banking and financial systems that could change the diffusion of the financial services business to all kinds of new players.

Twenty years ago, technologies like online payments, mobile banking, and e-commerce were in their early stages. Today, they have become commonplace tools for banks and financial services worldwide, which are rapidly integrating new technologies and services. The banking and financial services industry is experiencing a technological revolution centred around the transition to providing online and digital services. This transformation leverages cutting-edge technologies such as blockchain, artificial intelligence (AI), cloud computing, machine learning, and customer data aggregation.

Cutting-edge technology in banking and financial services is undeniably reshaping the industry, necessitating more stringent regulatory frameworks and standards. With the ongoing digital transformation, the scope for financial malfeasance is expanding. Concurrently with the global proliferation of e-commerce, online banking, and rapid payments, illicit actors involved in cybercrime, payment fraud, terrorist financing, and money laundering are growing increasingly sophisticated. Consequently, financial institutions must strike a balance between detecting and preventing these illicit activities while ensuring adherence to evolving international regulations. Regulators are now focusing on emerging areas such as operational resilience and anti-money laundering compliance, in addition to established policy domains like climate risk, digital currencies, technology, and innovation.

This holds especially true given the pivotal role played by banking activities, specifically transnational intermediation, in the global political system. Intermediary banks mediate between the desire of savers to profitably lend money and the interest of borrowers to utilize it. Bank profits hinge on the spread between savers' and borrowers' rates. This group of borrowers encompasses various actors, including States and

even criminal organizations. In the 1980s, extensive and prosperous transnational networks, funded by proceeds from global trades in narcotics, weapons, and undocumented labour, emerged as financial actors aiming to transform illicit funds into untraceable investments.

Due to their capacity to swiftly mobilise financial resources, banks and financial centres wield a substantial degree of power. This not only enables them to influence or support governments, as they once did, but also empowers them to act in opposition to them. Consequently, banks and financial centres have claimed a significant role in the structure of international governance by reinforcing the policies of State actors through the cross-border banking sector, often seen as indispensable for the efficacy of State endeavours.

Thus, the paramount question of our time concerns not only holding banks and financial centres accountable for their actions, but also determining the appropriate balance of power between them and the State. This issue has come to the forefront in recent years, notably in the aftermath of financial crises, such as the one in 2008. The global financial crisis of 2008 had a profound impact on both the banking and financial systems and their regulatory framework. Since then, there has been a growing need to adapt new strategies and business models in response to the crisis, particularly through fortifying crisis supervision and resolution mechanisms.

In this context, the relationship between the stability of the banking and financial system and the equilibrium of global politics has garnered renewed interest in scholarly literature. Additionally, questions have arisen regarding whether States have ceded their sovereign authority in favour of the banking industry and the financial system.

Therefore, understanding the influence of banks and the financial system within the realm of global relations is imperative. Addressing this inquiry necessitates a re-evaluation of how we define politics and who wields power in society. This issue is closely tied to the broader topic of the role of non-State actors in the field of International Relations.

## **1.1 From a State-centric approach to power diffusion in international relations and political studies.**

As a sovereign entity, the State has historically been considered to be the main actor in the domain of international relations. This perspective risks largely ignoring the crucial global interactions of non-State agents which have been established over time and occur intensively nowadays.

Banks and financial centres, in particular, have started to utilise their ability to affect global developments through their spheres of influence. In many cases, they have taken on roles that are similar to, if not stronger than, those of States, or have even replaced States in a number of fields (Miyoshi, 1993).

The study of States as the primary actors in IR was emphasised by the realism paradigm that centred its analysis on State action originating from a sovereign body. Realism is founded on specific assumptions. The first premise asserts that the nation-State is the primary actor in the global political system, relegating other entities like individuals and organisations to a position of lesser influence. Secondly, realism posits that the state functions as a unified actor, especially in times of conflict, acting and speaking as a cohesive whole. Thirdly, decision-makers are considered rational actors who pursue the collective good through logical decision-making. It would be deemed irrational for leaders, regardless of their political leanings, to take actions that might weaken their states. Lastly, States exist in a condition of anarchy.

Following the Second World War, Hans Morgenthau (1948) developed an international theory heavily influenced by the writings of historical figures like Thucydides and Machiavelli. He contended that politics and society are governed by natural laws. Morgenthau advocated a strategy that prioritised power over morality, in contrast to more idealistic thinkers who believed that international issues could be resolved through transparent negotiations marked by goodwill. Morality, according to Morgenthau, should be set aside when making decisions.

Kenneth Waltz later modernised the theory in *Theory of International Poli-*

*tics* (1979), distancing realism from its less plausible assumptions about human nature. By emphasising the importance of 'structure', his theoretical contribution became known as 'neorealism' or 'structural realism'. Waltz proposed that a State's decisions and actions are determined by a straightforward formula, rather than being solely based on human nature. This approach involves two key elements. Firstly, an international anarchic system (the structure) is necessary for all States to coexist. Secondly, every course of action a State takes depends on its relative power compared to other states. Consequently, Waltz advocated a form of realism that urged researchers to focus on the characteristics of the global system for insights, rather than delving into the limitations of human nature.

Despite the diversity of internal theoretical perspectives, realists believe that the international system is constituted by anarchy, the absence of a centralised power, in which States are sovereign, and thus autonomous from one another (Waltz, 1979). State power is the primary, if not the only, variable of concern in such an anarchic system, because it is the only means by which States are able to defend themselves and have any chance of surviving. According to John Mearsheimer (1994), this worldview is based on four presumptions: every State's primary goal is survival; States are the only rational actors and they try to maximise their chances of surviving; all States have some level of military capability, and no State fully understands its neighbours, with the consequence that the world is unpredictable and dangerous; and finally, in such a world, the great power States, who have more clout economically, play a dominant role. State-level analysis has, hence, long been the sole paradigm in the global political system. Realists contend that non-State actors, such as non-governmental organisations, individuals, or international organisations, are essentially instruments of States. They play a subordinate role in the broader inter-State dimension of global politics and lack the capacity to fundamentally alter the beliefs or behaviour of States (Waltz, 1979). Non-state actors encompass organisations that are "largely or entirely autonomous from central government funding and control; originating from civil society, the market economy, or political impulses beyond state influence and direction". These entities operate "in ways that impact political outcomes, either within one or

more states or within international institutions, whether purposefully or semi-purposefully, either as their primary objective or as one facet of their activities” (Josselin and Wallace, 2001:3-4).

Although the primary focus of the study of international relations has historically been on the analysis of States and their interactions with one another, both liberalism and neo-realism recognise the existence of non-State actors as the subject of a theoretical discussion. In the mid-1970s, a group of scholars known as ‘liberal pluralists’ reached a pivotal conclusion: States are not independent and or uniform actors within the political system. Instead, States are composed of competing bureaucracies, and the traditional dominance of military and security concerns as policy drivers has shifted, with economic and social interests gaining even greater prominence. Recognising that the State-centric paradigm has overlooked the significance of non-State actors, Robert Keohane and Joseph Nye (1977) were among the earliest academics to advocate for a re-evaluation of this perspective. They acknowledged interactions that occur without the direct involvement of states and defined them as “the movement of tangible or intangible items across state boundaries when at least one participant is not an agent of a government” (1977:45).

Despite facing criticism from neorealism, the concept of the State, which is central to the realist approach, has maintained its prominence. In fact, despite the contention that the realist approach may overlook certain events due to its focus on States, several occurrences in the late 1970s and early 1980s demonstrated to researchers that the core principles of realism remained applicable to an analysis of global politics. These events encompassed conflicts between the East and the West, the advancement of US weaponry in contrast to Soviet armaments, the military interventions of superpowers in regions like Africa, Central America, and Southwest Asia, as well as the Yom Kippur War. International organisations appeared ineffective in influencing regional interests and seemed to represent a continuation of interstate conflict on a global scale. Nevertheless, these events prompted a re-evaluation of realism, leading to the emergence of neorealism.

Kenneth Waltz has incorporated systemic methodologies into the realist paradigm to explain how actors behave in light of the structural limitations that the global system currently faces. Waltz has maintained that only the important actors functioning inside the international framework should be used to describe it, not all actors. Waltz emphasised the role of these players and stated that while the nature of power had changed (and was thus distributed among different types of actors), its application had not. This approach was in response to the increased activity of non-State actors and the following criticisms of realism. In his book *Man, the State, and War*, Waltz (1959) proposed three levels of analysis of international relations: a macro-level (the international system); a micro-level (the national State); and the level of individuals.

In any case, the study of private actors has long been ignored, or criticised, in favour of other analytical approaches. According to some authors, although individuals' needs are a starting point for both domestic and international policies, it is theoretically wrong to deal with individuals within the constraints of the nation-State or of the international system.

As a result, even when attention is paid to individuals, it is only with respect to formal decision-makers as State representatives (Isaac, 1974). This approach emerges in works like those by James Rosenau (1997) who, while offering helpful insight for considering individuals, frequently overemphasises the structural social context of actors playing social roles: analysis at the level of the individual continues to be tied to the model of political leadership and is, thus, limited to individuals who have official roles and powers in the State and are able to exert a direct impact on the global scene (Byman and Pollack, 2001).

However, the field of international relations has encountered substantial challenges to its foundational theoretical framework following the end of the Cold War and the increasing interdependence resulting from globalisation. The core premise, which asserts that States are unitary actors, has faced intense scrutiny from various perspectives, including bureaucratic politics, domestic politics, transnational dynamics, and

regime models. As the boundaries of States no longer neatly align with national borders in the globalized context, a disruptive trend towards the emergence of 'Stateless nations' has been evolving (Lapid, 1994: 22).

In light of the interconnected world of the globalised era, Joseph Nye (1990) stated that emerging challenges that altered the dominance of the nation-State as a political unit where the state and nation are congruent, gave rise to the concept of power diffusion, which is centred on the increased role of non-State actors in world politics, and how these actors affect State authority. Power diffusion, according to the author (2011), is the transfer of authority from governments, whether in the East or the West, to non-governmental, or non-State, actors. Indeed, two significant power transfers are taking place in the 21<sup>st</sup> century: a 'horizontal' shift from Western to Eastern countries, and a 'vertical' diffusion of power away from States and towards non-governmental entities. This dissemination, which is fuelled by the present digital revolution, will result in a much larger number of actors participating in international politics than in the few centuries since the Treaty of Westphalia established the principle of sovereign immunity. Nongovernmental players have always had a significant impact, but the information revolution has greatly accelerated and expanded their influence, in light of the new transnational challenges, such as terrorism, global financial stability, cyber conflict, pandemics, and climate change. As Nye (2011a) explains, no government can solve these problems by acting on its own.

## **1.2 The open debate on non-State actors.**

In the 1980s, Mark Hoffman (1987) considered that the field of international relations has been characterised as being at a crucial crossroads. In terms of theory and research, the heritage of realism still rules the area, but different viewpoints are threatening this authority.

Neo-Gramscian critical theory,<sup>1</sup> feminist theories,<sup>2</sup> constructivism,<sup>3</sup> and liberal pluralism, have challenged realism's explanation of international affairs and offered some alternative viewpoints).

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- <sup>1</sup> Neo-Gramscianism examines how the State, the prevailing ideational framework, and specific social factors shape and sustain global regimes. This approach transcends the historical impasse between realist and liberal theories by contextualizing the theoretical foundations of both schools within a particular world order. It also highlights the mutually reinforcing relationship between agency and structure. The theory draws from Antonio Gramsci's concepts of cultural hegemony and the State, which diverge significantly from the realist notion of hegemony. In Gramsci's view, the State and the bourgeoisie, or ruling class, employ cultural institutions to uphold power in capitalist societies. The bourgeoisie establishes a hegemonic culture through ideology, rather than relying on coercion, economic leverage, or violence. The major proponents of this theory include Theodor Adorno, Karl Polanyi, Karl Marx, Max Weber, Max Horkheimer, and Michel Foucault.
- <sup>2</sup> Feminist International Relations (IR) theory emphasises the importance of considering how gender influences the modern global political economy, expanding the traditional focus of IR on States, warfare, diplomacy, and security. Its popularity gained momentum in the late 1980s, driven by the evolving landscape after the Cold War and a re-evaluation of established IR theory in the 1990s. Feminist studies primarily aim to challenge the politics of knowledge formation within the discipline, often by adopting deconstructive methods associated with post-modernism and post-structuralism. This aligns with feminist IR's broader connection to the critical discourse in IR. While reflecting the liberal feminist emphasis on women's equal opportunities, feminist and women-centric approaches are gaining traction in international policy circles, exemplified by institutions like the World Bank and the UN. Cynthia Enloe, in her work "Gender is not enough: the need for a feminist consciousness," contends that discussions on conflict in international relations must also consider issues related to men, boys, and masculinity. Enloe urges scholars in international relations to approach these matters with a "feminist consciousness" Cynthia Enloe, "Gender is not enough", *International Affairs* (Royal Institute of International Affairs 1944-) Vol. 80, No. 1 (Jan 2004): pp95-97. Oxford University Press.
- <sup>3</sup> Constructivism lacks the distinctiveness of realism and liberalism in political science, and it is more of a general social theory than a paradigm. This method places ideas at the centre of how social life is organised, undermining theories like biology, geography, and technology that use materialist justifications to explain social existence. Although these play a part, the meaning is mediated by concepts. Similar to this, the interests and identities of the players in the international system are influenced by their socially organised conception of the world. The person associated with this approach, Alexander Wendt, uses three key terms: identities, which define the players' identities; norms, which are understood as common expectations for the appropriate behaviour given the actors' identities; and interests, which describe the actors' goals. Alexander Wendt, "Anarchy Is What States Make of It: The Social Construction of Power Politics," *International Organization* 46, no. 2 (1992):391-425. Alexander Wendt, "Anarchy Is What States Make of It: The Social Construction of Power Politics," *International Organization* 46, no. 2 (1992):391-425.

Despite their different approaches to the global system, they assess global politics and nation-State behaviour taking into account non-State actions (Krasner, 1982). "The world polity is in the process of self-transformation - out of the traditional nation-State structure and into a system more congruent with the contemporary global polyarchy", claims Seyom Brown (1995: 268) As the degree of interconnection in the global environment increases, so does the significance of non-State players in IR. The various theories simply differ in their assessments of the significance and effectiveness of non-State actors.

Neoliberals agree with realists' State-centric viewpoint, but they also contend that international institutions are a vital component of the global system and play a significant role in world politics. Yosef Lapid states that "the gap between the 'nation-state' ideal and political reality seems to be actually growing rather than narrowing", since "recent technological, economic, and social developments have posed enormous challenges to the capacity of territorial States to fulfil their traditional functions of security, welfare, and identity" (1994: 23, 24).

In the globalised interconnected world, the indistinguishability of public and private matters, national and international affairs, as well as political, economic, and social issues, are emphasised. According to Andrew Bennett (1991), in this framework, non-State actors have started playing a role, and private economic and social activities, which affect the values accessible to other players, are regarded as political behaviours.

The distribution of power and the participation of non-State actors are considered to be two closely related topics. Realists contend that power is the primary factor in explaining why States behave in anarchic international systems where collaboration between nations is impossible since States only look out for their own short-term interests. Non-State players, including international organisations, have no impact in this dimension. However, Robert Keohane (1984) argues the possibility of international cooperation for the achievement of long-term interests, in relation to which, the influence of non-State actors in international

politics is considerably significant. It is recognised that cooperation between nation-States, transnational organisations, and civil society is essential to addressing the problems brought on by the end of the Cold War and the effects of globalisation, such as religious fanaticism, hyper-national ethnicity, divisions and hatreds, cultural disparities, and economic imbalances (Kegley and Wittkoph, 1995:122). Numerous non-State actors have been involved in these phenomena, and they have started affecting local, regional, and international affairs.

In order to protect their interests, nation-States, even the most powerful ones, must give non-State actors a high priority. In order to be able to conduct reliable assessments of global politics, any new theoretical and conceptual approaches to international relations must take into consideration non-State players and new circumstances. Among the non-State actors, banks and financial institutions have increasingly played a large role in modern international relations.

## **Section Two: The role of banking and financial systems in the framework of States' government: A literature analysis**

In the study of IR, there has been a long and deafening silence on the role of the banking and financial systems in international decision-making and power processes. In the eighties of the 20<sup>th</sup> century, Robert Gilpin argued that the increased role of the international monetary system constituted "a virtual revolution in world politics" (1987: 118). It was a revolution that had rarely ever been acknowledged or discussed in IR before. However, there was no sequel to Gilpin's reflections (Strange, 1998). Indeed, the public debate since the mid-1960s, and most of the academic writings by economists and others, focused on currency and the exchange rate problems, and not on the organisation of the banking and financial system. For example, Robert Keohane and Joseph Nye's earlier and influential work *Power and Interdependence* (1977), in giving a State-centric definition of the monetary area of the issue, limited their analysis only to currency and the exchange rate, without taking an interest, for example, in transnational flows. Generally, in IR

studies, there has been a long absence of any consideration of the structural power of the banking and financial system which - as Karl Polanyi (1957) clearly sensed - could directly affect both the international political system and national politics.

Unquestionably, the prevalence of attention to violent conflict and war between States can be used to explain the long abandonment of IR studies in the banking and financial system. These are the two themes that have elevated the significance of studying world politics from the side of the realists of the 1930s, such as E.H. Carr, Georg Schwarzenberger, and Frederick Schumann, and of the 1950s, such as John Herz, Hans Morgenthau, and Ken Waltz. Moreover, as Susanne Strange argues (1998), the lack of attention is based on the supposition that IR politics are also distinct from national politics, on the basis of their respective normative systems: indeed, in contrast to domestic law, which is supported by political authority and stable institutions, international law is fluid.

Even though the IR authors' manuals of the time (Waltz, 1979; Ray, 1995; Aron, 1973; Claude, 1962; Bull, 1977), include chapters on transnational corporations, ethical and environmental concerns, and secondary actors in a State-centric system, there is no analysis of the role of banking and the financial system in the politics. Today, there is much debate on the separate lines that should be drawn between international law and domestic law, and, in turn, between international politics, including foreign policies, and domestic politics (Keohane and Milner, 1996; Rosenau, 1997).

## **2.1 The swing of power between the financial system and political authority in the IR studies: The theory of Susan Strange**

A decade after Gilpin's work, Susan Strange, in her work *Mad Money* (1998), recalling the dominant themes that are reflected in her work since the 1970s, highlights three specific themes: (i) the need to include the international finance policy system in the study of international rela-

tions; (ii) the need to go beyond liberal politics and economics theory and recognize that the structural power of capital is not constant, and, therefore, cannot be arranged in the logic of liberal economy (unsurprisingly, Strange uses the term 'mad money' (1998)); and (iii) the need to recognize that 'areas of significant ignorance' in our understanding of the role of the international financial system in an era of technological revolution and globalisation are getting bigger rather than smaller. Regarding this last point, in her 1970 article, *International Economics and International Relations: A Case of Mutual Neglect*", Strange has already argued that the international political economy is centred on power, and economics has an impact on IR. For Strange, there are two types of power; relational power and structural power. While relational power refers to physical and material capabilities that can be measured and estimated, structural power refers to "shaping and determining the structures of the global political economy (or international system) within which other States, their political institutions, and their economic enterprises, and (not least) their scientists and other professionals must operate" (1988: 42). In other words, structural power provides a framework for key decisions affecting the international order. According to Strange (1988a), four major world structures – production, security, finance, and knowledge – are connected in a quadrilateral, such that, despite their varying weights, none is more significant than the others. These four major global structures influence and benefit actors holding structural power.

By highlighting the structural relevance of the relationships between States and banks and financial systems (Katzenstein, Keohane, and Krasner, 1998), Strange became one of the first proponents of the idea that scholars of international relations should study both politics and economics (Brown, 1999; May, 1996). However, although in the current global system, banks and financial centres have a significant influence over State actions and IR, relatively little is known about how banks influence IR and politics (Bernhagen, 2007; Swank, 1992). Because of their focus on institutions and power, international relations experts have historically had a poor knowledge of international economics, and, conversely, economists have historically had a poor understanding of power.

In *States and Markets* (1988), Strange hypothesizes that the most neglected channel of power is financial access, which is also the most important because it allows us to understand how the world works. Her analysis focused on what she called 'the authority market nexus'; the swing of power between the financial system and political authority. According to the author, by the 1970s, a dangerous gap had been emerging between States and the global banking-financial system: while nation-States were bounded by territorial boundaries in a world of fragile intergovernmental cooperation, banking and financial markets would be able to violate regulations and reign free, creating more uncertainty and risk in an already chaotic environment. Therefore, the topic of what kind of power banks hold needs to be examined.

## **2.2 The banking and financial system as the 'third dimension of power' of Lukes' theory.**

Michael Barnett and Robert Duvall define power as "the production, in and through social relations, of effects that shape capacities of actors to determine their circumstances and fate" (Barnett & Duvall, 2005: 39, 55). This formula disavows notions of power that conflate power with all effects, since doing so equates power with causality. Taking into account this approach, this essay examines the influence of banks and the financial system by starting with Steven Lukes' theory. When, in 1974, Lukes published the work, *Power. A Radical View*, American political science was dominated by diverse schools and a heated internal debate about the structure of power. In the 1950s, the 'theory of elites', through the works of Charles Wright Mills (1956) and Floyd Hunter (1953), highlighted how power at the national and local levels was always exercised by an elite of an economic nature.

Robert Dahl's attempt to found pluralism on the overcoming of the theory of the elites gave life to a new line of studies, destined to shift the central core of the analysis of the power structure of a society in the decision-making processes within which power is exercised. Like other main exponents of pluralism such as Nelson Polsby and Raymond

Wolfinger – Dahl maintains that the analysis of the exercise of power starts from the assumption that, in a context characterized by a multiplicity of conflicting interests, power must establish the conditions for its exercise, in order to try to mitigate this conflict (1959). It is from pluralism that Lukes started to argue that power must be seen in a broad sense and that it is necessary to analyse its less evident aspects. Lukes' perspective is positioned along an ideal line that perceives the contrast between conflict and consent as the two extremes, with a series of internal gradations, ranging from assent to submission, from persuasion to manipulation.

Lukes (1974) defines power in terms of what he calls 'dimensions': namely, decision power, non-decision power, and ideological power. What makes the difference is the third dimension of power which is based on the assumption that, for Lukes, power is such if it is not only exercised in decision-making processes, but also in controlling the agenda of the issues on which to make decisions. True power is an ability to influence, not an actual exercise, and the less visible that power is, the more effective it is. The third dimension, which Lukes (1974) provides as an 'in-depth critique' of the behavioural emphasis of the first two dimensions of power, consists, in fact, of influencing or determining the wishes of others, and allows us to take into consideration both the visible and latent conflicts that are excluded from the political process. Lukes uses the third dimension of power to describe corporate dominance in the contemporary world, which is based on free market ideology and thought to be the only viable option (Kegley and Wittkoph, 1995; Miller, 1994).

Regarding the banks and financial centres, their way of influencing States is evident. Indeed, let's consider the financial lobby in Europe after the 2007/2008 crisis. The 2008 global economic collapse, which fuelled a financial crisis, made clear the financial markets' huge influence and destructive power, and, as a consequence, the critical necessity for stricter regulations on financial markets. The financial lobby in the European Union has been successful in waging campaigns against reform, which has made it difficult. Its ability to block measures it doesn't like has been

made painfully clear in cases involving banking regulation, derivatives, credit rating agencies, accounting standards, and many other topics. In total, the financial industry lobby in the European Union (EU) has access to more than 700 organisations, more than 120 million euros in annual spending, and at least 1700 lobbyists, including all banks and businesses concerned with financial regulatory concerns.

This implies that, for instance, a Commission public officer will deal with four financial industry lobbyists. These individuals take action during the planning stages of legislative proposals and policy initiatives to provide advice to the Commission within the very earliest stage of the decision-making process, affecting the outcomes of EU law (Wolf et al., 2014). This paradigm also demonstrates that other actors, in addition to States, are involved in the current global issues that demand State regulation, such as climate change, conflict, food shortages, poverty, overpopulation, and a lack of natural resources (Kegley and Wittkoph, 1995; Miller, 1994).

Therefore, by applying Lukes' theory, it can be said that the power of banks and financial centres can be considered a part of the third dimension because they have the ability to influence States, more so than to set their agenda. But can banks and financial institutions merely exert influence over the States, or can they also directly determine the IR agenda?

### **2.3. The power of banks and financial centres: Beyond Strange and Lukes' theory**

If the theories looked at thus far help to comprehend the functions that banks and the financial sector play in IR, the definition of the kind of power possessed by these non-State players is still up for debate. Can it be argued that banks and financial institutions just have the ability to influence States, or are they also capable of acting as IR's decision-makers? How do they interact with States in this last instance?

Banks and financial centres are actually proving to be capable of determining political and economic outcomes globally, in a clear and non-subtle manner, as well as of influencing the general public and