Jeffry Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization*, Vo. 45, No. 4 (Autumn 1991), pp. 425-451.

In short

International capital mobility does not completely constrain the ability of states to enact economic policy. Different socioeconomic groups will exhibit different preferences where instruments of international financial integration are concerned. These groups will organize themselves according to sector.

Central Question

How has increased capital mobility affected patterns of preferences for financial integration? How does this extend to preferences with respect to exchange rate levels and flexibility?

Central Hypotheses

Socioeconomic actors respond to financial integration based on how they are impacted by increases in capital mobility. In the long run, international financial integration favors capital over labor, particularly in developed countries, but in the short run, the effects of integration turn on asset specificity, with respect of use and location. Increasing capital mobility impacts producers of tradable goods and services differently than it impacts producers of non-tradables.

How he makes his argument

First documenting the increase in capital outflows and bond and bank lending, as well as the increase in short-term foreign exchange trading and financial transactions, Frieden asserts that "borders and currencies are still substantial barriers to investment flows," (428). Asset prices and returns differ in different countries, reflecting the greater uncertainty associated with cross-border capital movement. Moreover, different types of assets exhibit differing degrees of mobility across borders—financial assets tend to be more mobile, which means that national economic policy, whereas technological and managerial skills are more specific. Increased financial integration has only a limited impact upon industries dominated by location-specific capital, by impacting the ease with which new firms can enter a particular sector. However, financial integration impacts the distributional consequences of national macroeconomic policies. For example, investors can sell the currency of a state engaging in monetary expansion, causing a currency depreciation that causes the prices of domestically-produced goods to decline relative to those of foreign-produced goods, which favors domestic exporters. Fiscal policy also impacts the domestic exchange rate.

In an effort to understand whose preferences are going to change and how in a world with capital mobility, Frieden reviews the Heckscher-Olin trade model, particularly its Stolper-Samuelson offshoot, which asserts that the distributional consequences of capital mobility depend upon the abundance of particular factors with a state. Frieden contends that this model falters as the number of factors involved goes above two, and as assets become immobile within a polity. He thereby introduces an alternative "specific-factors" model, whereby "changes in the relative prices of goods have their principal effect on the sector-specific producers of the goods," (436). Economic activity is organized into sectors, characterized by some specific factors and some mobile factors, whose respective interests conflict in the event that the supply of a mobile factor (such as financial assets) changes. Frieden contrasts his view with the class-based approach by arguing that short-term sectoral interests trump longer-term class interests. In world of capital mobility, Frieden concludes that life is better for owners of financial assets in capital-exporting countries and for owners of sector-specific assets in capital-importing countries, in addition to multinational corporations. These groups will thus favor increased international financial integration.

Frieden applies his logic to generate predictions about policies concerning the removal of barriers to capital movements across borders, as well as efforts to strengthen the monitoring of international financial markets through international organization. He argues that American support for the IMF comes from precisely those sectors that he would expect—US financial centers and internationally-oriented non-financial corporations, whereas domestic manufacturing and farm groups have either opposed American involvement in the IMF or registered ambivalence about it. Similarly, European financial and monetary integration has found its strongest support among financial and multinational firms on the continent.

Having established the different sectors experience different distributional consequences from financial integration in the face of capital mobility, Frieden turns to the extent to which sectoral preferences will turn into policy

outcomes. He contends that greater specificity increases the incentive of an asset's owner to lobby the government. The ease of exit provided by capital mobility in turn decreases the incentive for investors to lobby the government, although Frieden does not believe that the decrease has been large in magnitude. Frieden asserts that differences in policy preferences along sectoral lines are most evident on the issues of exchange rate levels and the degree of exchange rate flexibility and national monetary policy autonomy. For example, fixed exchange rates in a world of mobile capital prioritizes a stable exchange rate over the ability of national policy to affect domestic prices—something that is most attractive to international traders and investors. On the other hand, producers of nontradable goods and services are not concerned with foreign exchange, and therefore favor flexible exchange rates in order to maximize state autonomy from market fluctuations. Import-competing producers of tradable goods for the domestic market similarly favor a flexible exchange rate, because they are most concerned with national policymaking autonomy. Where exchange rate levels are concerned, producers of tradable goods will prefer a depreciated currency, as it favors their goods over non-tradables. In search for supporting evidence, Frieden extends his argument to apply to preferences for macroeconomic policies, and describes how President Reagan's primary support came from the non-tradables sectors, which led him to enact loose fiscal and tight monetary policy in line with the preferences that Frieden predicts for those sectors. Frieden closes his paper by conceding that political outcomes will depend upon the intensity, concentration and organization of preferences, as well as the institutions in which they are expressed.