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Institutional Change in the Regulation of Financial Markets: Questions and Answers

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The formation of a research network

The near-collapse of the international financial system in 2008, with its dire consequences for the real economy and state budgets, has generally been perceived as a major global crisis. Crises command the attention of politicians, experts, and the general public and are expected to trigger responsive action. The financial crisis focused political attention first on measures to contain it—in other words, on crisis management—while economists and social scientists started to analyze its causes. Soon there was wide agreement that one prominent cause had been the failure to regulate the internationally expanded financial markets in such a way that their crisis potential—the "market failure" to which they were prone – would be contained. The existing formal rules had significant gaps and created incentives for circumvention and deviation. Banks had not been required to retain on their books part of certain securities they issued; hedge funds and private equity firms were not required to comply with the capital standards of Basel II; and the over-the-counter (OTC) trade of derivatives did not have to be registered, to name just a few of the regulatory gaps that permitted the financial markets to become bloated with "toxic" assets. In unregulated spaces, new practices developed which contributed to the crisis. This holds for the construction of "innovative" financial instruments, such as structured asset backed securities and credit default swaps. At times the effort to avoid compliance with existing rules led to the invention of innovative forms of circumvention; a prominent example is the creation of special purpose vehicles by banks. The new practices that had developed within the given regulatory framework helped to spread the financial crisis to other sectors and other countries when the bubble based on US subprime mortgages burst. "Market discipline" and efforts at self-regulation had obviously been insufficient to prevent the financial crisis; changing the regulation of financial markets therefore appeared the appropriate response.

The observation and analysis of regulatory responses to the crisis was an obvious challenge to sociologists, political scientists, and political economists interested in institutional change. Relevant research started in many places, but

clearly no single research institution was able to set up immediately an empirical project covering all aspects of institutional change triggered by the crisis. This also held for the Max Planck Institute for the Study of Societies (Max-Planck-Institut für Gesellschaftsforschung or MPIfG), whose research program focuses on markets and on institutional change. The MPIfG therefore decided to provide instead a platform for the formation of a collaborative network of researchers dealing with specific aspects of the process of institutional change triggered by the financial crisis.

The study of institutional change requires specification of its empirical referent. The term "institution" is applied to specific normative regimes, to normatively structured social sub-systems, and even to single organizations such as constitutional courts. Financial markets can also be regarded as institutions. They are based on general norms such as property rights, and are peopled by market actors shaped by and subject to legal norms and collectively agreed standards. However, for the network project we decided not to focus on possible future change in financial markets, but on change in the institutions designed to regulate them. Research into institutional change in respect of financial market regulation addresses the structure and practice of supervision, as well as the formulation of new rules, the amendment of existing laws, and the modification of existing standards taking place at different political levels, from the national to the European and the international.

The first steps of network formation were taken in the fall of 2009. In December 2009, Renate Mayntz invited a number of social scientists known to be engaged in relevant work to join the project. In the same month, Till Kaesbach joined the MPIfG to assist with network coordination, and to collect material to keep abreast of the unfolding reform process. The purpose of the network was to gain insight into features of the many-faceted change process that cannot be obtained in a project covering only one component of the financial and regulatory system: features such as the phase structure of the overall process, the relative dominance of activities at different political levels, or the role played by different types of agents, both supporters and opponents of regulatory change. It is this emphasis on the dynamic and characteristics of the macro-process of institutional change then under way that distinguished the MPIfG enterprise from the multitude of studies devoted to a particular agency, financial instrument, or country. In February 2010, seventeen scholars met for a workshop to discuss the aim, design, and guiding questions of the network enterprise, and to suggest additions to the group. Future network members were to contribute, based on their ongoing research, an account of regulatory reform taking place either in a specific country, at the European level, or with respect to an international agency, regulatory standard or financial instrument. Institutional change

was to be studied not simply as an outcome, but as a process unfolding over time (see Hall 2006).

When network formation started in 2009, the financial crisis had already led to a wide-ranging reform discourse. It did not seem unreasonable at the time to assume that by 2011 the process of institutional change would have reached a stage warranting assessment and analysis. At the workshop in February 2010 network members therefore planned to reassemble in a year to present the results of their studies. By the summer of 2010, the network counted 22 members from six different countries. As planned, the concluding workshops of the network took place at the MPIfG in February and March 2011, respectively.

This volume contains a selection of the workshop contributions, nearly all of them in a substantially revised form; revision lasted until September 2011. Not all network members are found among the authors of this book. The aim has been to produce a volume of manageable length, concentrating on events at the three political levels involved in the change process—the national, the European, and the international—and paying more attention to changes in agencies and in rules applied to market actors than in financial instruments. Special emphasis has been put on studies dealing with regulatory change in given countries, for one thing because it turned out that the national level—and in particular the United States and the big European countries—has played and continues to play a dominant role in the regulatory reforms under way globally. This neglects, but does not intend to disavow the importance of the emerging economies to the development of the global financial system—a topic treated in other publications (for example, Underhill/Blom/Mügge 2010). An attempt has been made to have the country chapters answer a common set of questions, but as the network project had not been set up as a comparative study of national responses to be analyzed, for instance, within the framework of the varieties of capitalism approach (VoC), there are considerable differences in the approach, style and implicit normative flavor of these chapters.

The process of change in financial market governance triggered by the financial crisis of 2007/2008 had not fully run its course when, towards the end of 2011, this book went into print. Meanwhile, a second shock wave—the sovereign debt crisis—has overlaid the shock wave of the financial crisis, and the attention of politicians and social scientists alike has shifted to the new crisis. This gives some post-hoc justification to the initial decision to follow institutional change in financial market regulation only until 2011, when it could still be connected to the financial crisis of 2007/2008. As analysts of institutional change are well aware, change processes have no objective beginning or end, but are entities defined by those who decide to investigate a given stretch of socio-political development; whatever happens during that period will take on a new

meaning if looked at from some later point in time. The open-endedness of the process analyzed in this book inevitably makes its assessment provisional.

Questions

The questions the network project set out to answer refer to the macro-process of institutional change, but to answer them the individual contributions had to supply factual accounts and focused explanations of what happened in a given country, a given agency, or with respect to a given financial standard. Having graciously accepted this discipline, all authors set out to collect data specifically for this publication. As a result, the chapters in this volume provide valuable case analyses; taken together they give at least tentative answers to the more general questions that were formulated at the beginning of the collective enterprise.

The guiding empirical questions were directed at the process of change, its outcome, and the factors at work in generating that outcome. Macro-processes of planned institutional change move through several phases. Gaps can develop between initial reform intentions and subsequent action, and reform targets can change. Since national, European, and international decision-makers were involved, the question of the relative dominance of a given political level in the reform process was raised. As for the outcome of the change process, we were interested in changes of regulatory structure, and changes in rules. Would there be a pronounced shift away from self-regulation, would agencies disappear or be newly created at the different political levels? Would existing rules become stricter, would there be new rules (legal norms, standards) to guide the behavior of financial market actors and market transactions? With respect to change factors, both the role of potential change agents (drivers as well as opponents) and the role of perceptions and ideas were to be looked at. Since these empirical questions referred to features of governance rather than markets, answers to them were to be interpreted mainly within the framework of theories of institutional change, and of governance. However, all authors were free to develop their own theoretical perspective.

When the results of research undertaken in 2010 were presented and discussed at the workshops in 2011, attention had shifted from the question of *what* was changing, to the question of why so *little* change had taken place. This became a paramount topic in most of the chapters in this book. The results of the collective enterprise thus contribute, more than initially expected, to a theory interested not generally in the trajectory of change processes, but specifically in the conditions making for either radical or incremental institutional change.

The financial crisis did appear to be a "big bang" event that could well have led to radical change. Why did this not happen? When do shocks fail to engender radical change? The case-specific answers to this question may be the major theoretical contribution of this volume.

Answers

In the following sections of this introduction I attempt to formulate answers to the questions that have guided the network enterprise. These answers are based nearly exclusively on the material presented in the eleven following chapters, making good on the promise that the individual contributions of the network members will make it possible to answer more general questions about the institutional change in financial market regulation after the crisis of 2007/2008. What I am presenting is my own summary of this material, not the consensual view of all authors. To make reading easier, I have tried to limit the number of explicit references to chapters in the book by adopting the following rule: whenever one of the countries that are the subject of chapters 2–6 is mentioned by name (for example, the United Kingdom/British) and no other reference is cited, reference is to the corresponding chapter in this book.[1]

The macro-process of change

To identify change presupposes knowledge of the status quo. By necessity, the chapters in this volume therefore devote space—some more, some less—to the institutional arrangements of financial market regulation in a given country or agency or at a given political level as they had developed up to the outbreak of the crisis. The changes in financial market regulation motivated by the financial crisis of 2007/2008 are part of a long historical process. Since World War II, the globalization of financial markets, and financial crises in different parts of the world, have repeatedly led to institutional change in financial market regulation. Starting in the late 1970s, two parallel developments took place. As shown in several of the country chapters, there has been, on the one hand, increasing regulation: supervision was strengthened and tended to become integrated, and standards claiming compliance internationally were developed. On the other hand, however, in the financial markets, both market actors and transactions

1 US = chapter 2; Britain/UK = chapter 3; France = chapter 4; Germany = chapter 5; Switzerland = chapter 6.

were increasingly deregulated. Rather than being contradictory, these developments were two sides of the same coin. As the liberalized financial markets continued to change without commensurate changes in the regulatory framework, a regulatory gap developed which became manifest in the crisis of 2007/2008.

The changes in financial market regulation that occurred in response to the crisis can hardly be described as a single change process. A multitude of heterogeneous actors operating in a multitude of different sites were involved in the generation of the crisis, and in the response it triggered. In contrast to a natural event such as an earthquake or tsunami, "the financial crisis of 2007/2008" is an aggregate of many events; as a single event it is a cognitive construction. The process of institutional change we set out to study is again composed of many separate, but interdependent change processes. And yet it is possible to discern something like a macro-pattern.

The immediate reaction to the crisis was crisis management: at the national, European, and international levels. As crisis management succeeded in preventing the "meltdown" of the financial system and a sudden and major disruption of the real economy, it opened the way for reforms—in other words, for a process of planned change in the governance of financial markets. Public discussion focused first on guilt attribution, while financial experts in central banks and other institutions, as well as academics tried to understand how the unexpected crisis developed. Guilt was attributed to "greedy bankers," before the focus shifted to the behavior of rating agencies, the unregulated use of recently invented derivatives, and the structure of modern banks. Guilt attribution and causal analysis led to the formulation of demands for change. More quickly than public opinion, policymakers realized that in a culture in which the pursuit of individual interest is legitimate, moral suasion will not suffice to change the behavior of the financial institutions accused of having caused the crisis. In unusually wide agreement, politicians, heads of supervisory agencies, and academic experts reasoned that since financial markets had evidently failed to regulate themselves through what is euphemistically called "market discipline," radical regulatory reform was needed. Reform demands summarized in a flurry of official reports prepared, among others, by the Stiglitz commission (United Nations 2009) and the OECD (2009) were comprehensive, and directed at the financial system as a whole. This was expressed clearly by the heads of government at the G20 Summit in London: "We have agreed that all systemically important institutions, markets, and instruments should be subject to an appropriate degree of regulation and oversight" (G20 2009).

As time went on, reform demands became more concrete—and more selective. Although the chapters in this book show that there were differences between levels and countries, reform plans by and large tended to be directed

first at uncontested causes of the crisis, where the necessary change was at the same time relatively easy to define. From the compensation schemes for bankers, the capital reserves that banks were obliged to hold, and the behavior of rating agencies, the reform agenda moved to more difficult topics, such as ways to reduce the moral hazard posed by systemically important banks that were "too big to fail." As reform demands were translated step by step into concrete legislative initiatives and international standards, reform plans at all political levels and in all the countries we analyzed met with opposition. This resulted in compromises and in significantly delayed implementation requirements. Even before the sovereign debt crisis made regulatory reform of the financial markets appear less urgent, the slowing reform impetus was publicly noted and criticized by experts, as well as by heads of government.

This summary description of the change process as it emerges from the chapters of this book glosses over the interesting differences between political levels, countries, and agencies in the way the reform process played out. It is nevertheless evident that this particular change process differs from the familiar model of a policy cycle. A "policy cycle" starts with the identification and articulation of a problem, followed by political agenda-setting, the formulation of alternative solutions, choice of an alternative, and finally implementation (see, for instance, Windhoff-Héritier 1987). Different from most policy processes, the financial crisis was not a problem that needed identification and definition before it made its way onto the political agenda. It imposed itself suddenly and forcefully as a problem of systemic importance on politics, market actors, and the general public alike. There was no doubt that immediate action was needed. In other words, the financial crisis was generally perceived as a "big bang" event that shattered an arrangement believed to be fundamentally stable, notwithstanding periodic ups and downs.

The dynamic of policy processes provoked by a crisis obviously differs from that of policy processes preceded by a period of relative stability, with a slowly shifting change in the balance of power between critics and supporters of the status quo that leads finally to the articulation of a policy problem. As is generally recognized in institutional theory, particular institutional arrangements have distributional consequences that motivate supporting or opposing, defending or trying to change the status quo (Streeck/Thelen 2005; Hall/Thelen 2008; Mahoney/Thelen 2010). In the contest between social groups supporting or wanting to change the status quo, political actors may take sides or serve as mediators (Amable/Palombarini 2008). In our case, however, the pre-crisis mixture of regulation and deregulation that appeared to support economic growth had prevented the development of two opposed social blocs, one challenging and one defending the status quo. As noted in some of the chapters here, there were

experts and regulators who would have preferred stricter regulation, but they remained voices crying in the wilderness. It was the crisis that led to a wave of criticism and the demand for radical reforms, but the critics scarcely formed a single social bloc. As the reform plans impinged upon (previously unchallenged) vested interests, they stimulated the formation of opposition. But again this opposition, created by the incipient policy process, was not a coherent social bloc. As the chapters in this volume show, those who supported and those who opposed regulatory reform varied from issue to issue, between political levels, and between countries. Even in the phase of deciding on concrete reforms we cannot speak of two circumscribed social blocs pitted against each other.

Nevertheless, the outcome of the interaction between supporters and opponents of change was a loss of momentum: the change process slowed down over time. While a movement from broad to narrow and from ambitious to modest is not exceptional for planned institutional change in a non-revolutionary situation, it is unusual that this is encountered already in the early stages of the process by publicly voiced disappointment and criticism. The widespread public denunciation of the gap between initial reform demands and the forthcoming changes attests to the strength of the initial conviction that substantial change was needed.

Changes in financial market governance

Turning to the changes in the overall structure of financial market governance that took place in direct response to the crisis of 2007/2008, the most obvious effect has been a shift away from private self-regulation towards public regulation. Existing regulatory and supervisory agencies at all political levels of course reacted to the crisis. Most immediately and visibly, however, political actors became involved. On all political levels, the process switched suddenly from the previous "low politics" to "high politics." Symptomatic of politicization at the international level was the mutation of the G20, formerly a low-key body of central bank governors and finance ministers—who rarely attended in person—to the "premier forum for our international economic cooperation" at which heads of government meet for highly publicized summits (Leader's Statement, Pittsburgh Summit 2009, Preamble point 19[2]). In Germany, the crisis reinforced existing demands for regulation. But also in, for example, the United Kingdom and the United States, where self-regulation and light-touch public regulation had been the order of the day, politicians and even heads of government now

2 Available at: http://ec.europa.eu/commission_2010-2014/president/pdf/statement_20090826_en_2.pdf.

called publicly for stricter regulation. Given that reform was felt to be urgent, it was the executive rather than political parties and parliaments that first became involved. In the United States, it was the Treasury that drafted the plan for comprehensive reform that became the basis of the Dodd-Frank Act; in Germany, the Finance Ministry together with the Ministry of Justice drafted the restructuring law later passed by parliament. What formerly appeared to be technical issues to be dealt with by experts was transformed into a publicly observed process of high-level policymaking. According to Helleiner and Pagliari (2010), the financial crisis, reinforcing a trend towards banking regulation already under way, may lead to a further shift from private and decentralized to public and centralized governance. The shift to public regulation is evident also in our study, but whether there is also a shift towards centralized regulation is doubtful, as will become evident when we turn to changes in the governance structure.

Contrary to early demands, regulatory change has been neither comprehensive nor internationally coordinated. Given the horizontal and vertical differentiation of the pre-crisis governance structure, an integrated reform process guided by a master plan covering all aspects of the internationalized financial system that had proven so problematic was not to be expected. Demands for a coordinated, international response, voiced in public statements of political representatives as well as in the reports and memoranda issued by the G20 and by national bodies (for example, Financial Services Authority 2009; Wissenschaftlicher Beirat 2010) met with the reality of a geographically (horizontally) and politically (vertically) differentiated governance structure. Regulatory competences were concentrated at the national level. The EU had largely refrained from using its legislative powers for the purpose of market shaping rather than market making (Scharpf 2010). The international standardization bodies—the Basel Committee BCBS, the International Organization of Securities Commissions IOSCO, and the International Accounting Standards Board IASB—depended on voluntary compliance with the rules they developed. As the chapter on France suggests, demands for reform at the international level sometimes went together with a weak domestic reform impetus. But by and large, there was an early flurry of disparate national initiatives, including the one-time British tax on bankers' bonuses and the German ban on short selling. At the same time, national authorities were also the dominant actors in negotiating higher level agreements: heads of state at G20 summits and the European Council, and representatives of finance ministries, central banks and supervisory agencies in the Financial Stability Board FSB, and the BCBS (chapters 11 and 10). National actors were thus the key change agents in the reform of financial market regulation (Mayntz 2010).

As is evident from the chapters in this volume, governance structures have changed most at the national and least at the international level. At the international level there were changes in the mandate, composition, and weight of some agencies in the overall process of regulation. Examples are the change of the former Financial Stability Forum into the FSB (chapter 11), the additional resources given to the IMF (chapter 12), and the focal role assumed by the BCBS in the reform process (chapter 10). But no new agencies were established at the international level, nor were existing bodies given the competence to make binding decisions for lower level jurisdictions and market actors. International bodies are still restricted to monitoring, recommending, and trying to coordinate.

More substantial change took place, at least formally, at the level of the EU, where a new agency, the European Systemic Risk Board, was created and where the three previously existing committees that were supposed to coordinate national supervisors were transformed into European supervisory agencies. These agencies have some decision-making power, and the competence to intervene, under certain conditions, in areas hitherto under exclusive national jurisdiction (see chapter 7).

Agency change has been most pronounced at the national level. In several countries, new bodies to administer fiscal rescue programs have been created and, especially in the United Kingdom and the United States, new regulatory agencies have been established. The most innovative change has been the new emphasis on macro-prudential supervision; in the United States and the United Kingdom new bodies were even created for this purpose, while in other cases existing bodies were explicitly given this task. Other changes in the supervisory structure appear less significant. While in the United Kingdom the integrated supervisory agency FSA is being dissolved and the central bank is becoming appreciably more powerful, in most countries there has only been some redistribution of regulatory competences between central banks and supervisory agencies. Whether supervision over banks, securities, and insurance should be integrated or not, and whether central banks should also perform supervisory functions has been an issue for decades. The financial crisis brought old domain conflicts to the surface again and provided a window of opportunity for reform initiatives that previously did not receive political attention and support.

In the course of organizational change at the different political levels, public agencies were given, by and large, more powers. At the same time, there has been an—albeit limited—upward shift of de facto power, and an even more limited upward shift of formal competences, the latter especially in the EU. But since legislative competence is still concentrated at the national level, this upward shift has meant that the downward connection between levels has become more important. Supported by the FSB, the G20 has strongly voiced the need for spe-

cific reforms and has "tasked" international organizations—notably the IMF, BCBS and IASB—as well as national and regional jurisdictions to become active (chapters 11, 12, and Bradford/Lim 2010). The standards formulated by international bodies, notably the BCBS, have been integrated into EU directives and have thus become legally binding for market actors and supervisory agencies in member countries (see chapter 7). Expecting a new or amended EU directive, member countries have in fact put off introducing new rules by themselves; this also holds for directives the EU developed independently.

The policy recommendations and standards formulated by international bodies have also shaped regulatory decisions taken by states that are not EU members. Legislative powers to effect institutional change are still concentrated at the national level, but national decisions are affected by higher level demands and rulings. In the formulation of these demands and rulings, national actors have again been active, but there is a difference between the domestic and international decision-making contexts, not least with regard to the interests pursued by the actors involved and the resulting conflicts of interest. The connected upward and downward movements in this multi-level policymaking process are reminiscent of the dialogue model found to characterize the relationship between the political leadership and the bureaucracy in German federal ministries (Mayntz/Scharpf 1975). The post-crisis policymaking process has still been fragmented, but by virtue of the cross-level connections it has clearly become, if not more centralized, more international.

Publicly voiced initial reform demands focused on legal provisions and standards, more than on regulatory agencies. Rules were to be tightened, to cover all critical components of the financial system, and to be coordinated at the international level in order to be applied uniformly down to the level of market actors and their transactions. Although rule change and agency change are two closely related aspects of institutional change, the evidence amassed in this volume suggests that rule changes may have been more deep-cutting than agency changes. Existing rules that mainly targeted banks have been tightened and extended, as in the case of the Basel Accord (see chapter 10). Regulation has also been extended to new targets, such as hedge funds, rating agencies, and OTC derivatives. Most of the changes in standards developed by the BCBS, IOSCO, and the IASB and already agreed on are micro-prudential, and bank-centric. There is, however, also increasing emphasis on the need for macro-prudential regulation, manifested in the introduction of countercyclical buffers (in Basel III) and national resolution regimes for failing financial institutions (as in Germany). In support of macro-prudential regulation, monitoring financial market stability has been re-emphasized at the international, European, and national levels.

In practically all the chapters in this volume, the regulatory changes realized when pending legislative decisions have been taken, new agencies are up and running, and new and amended rules are finally implemented are judged to be incremental rather than radical. Doubts are voiced particularly with regard to the ability of regulation to discipline risk taking by banks, to deal with the problem of a moral hazard presented by financial institutions too big to fail, and to counter the threat of domino effects resulting from the high degree of interconnectedness among market actors and transactions. There is, however, some ambivalence in most chapters concerning their assessment of the observed reforms, and naturally the authors' views sometimes differ on this. Thus while Jabko (in chapter 4, pp. 97–118) judges institutional change at the EU to be a "major transformation of its financial supervisory architecture," Quaglia (in chapter 7, pp. 171–195) is more skeptical, emphasizing that "the new agencies have limited competences and it remains to be seen whether they will be able to regulate the financial sector effectively." It is true that the radical changes in regulation demanded by some politicians and scientific experts when the crisis became manifest have not been achieved: required bank equity is still below 10 percent, the new, highly structured securities and credit default swaps have not been prohibited, tax havens have not been completely closed, and financial institutions have not returned to concentrating on their classical functions instead of seeking profit by proprietary trading. But there have been changes, and sometimes a set of related small changes may add up to a transformative change. The question is whether the given change is sufficient or insufficient to solve the problem. At the time, the problem was defined as the in-built proclivity of the financial system to undergo major disruptive crises. Regulatory reform was supposed to solve this problem, but the pervasive view now is that it has fallen short of this goal. By the end of 2011, the perception of what is amiss has of course changed, pushing the critique of failed regulatory reform into the background.

Factors shaping the process and its outcome

The changes in financial market regulation emerging from the chapters in this book and summarized in the previous section pose two closely related questions: why has change taken place with respect to some aspects of the pre-crisis status quo and not others, and why has it not been more radical? Both properties of the process outcome—its selectivity and its intensity—have been affected by a set of change factors that operated not only in one country, one agency, or at one political level.

One generally important factor determining the political response to the financial crisis of 2007/2008 has been the kind and severity of the threat it posed.

The impact of the crisis was felt most directly at the national level, but it was not a disruptive shock to all the countries dealt with in this volume. The severity of the impact and the extent to which it was banks, the real economy, or households that were affected, depended on particular features of the given financial industry. In the United States, households unable to pay their mortgages were severely affected. In Germany, the failure of the HRE, which had to be taken over by the state, shaped the problem: the goal of regulatory change was to avoid future costly public bailouts that delegitimize the political system. Where the impact was limited and coping quick and effective—as was the case in France—the general public and the media were enraged by bonuses and scandals involving individual traders, but perceived no vital threat and did not demand radical institutional change. As put succinctly by Johal, Moran and Williams (in chapter 3, pp. 67–95), "crisis management both opened up and closed off possible paths to the post-crisis institutional order."

Although this study does not provide data with which to measure comparatively the impact of the crisis, it seems that the two liberal market economies, the United States and the United Kingdom, suffered a severer shock than the three other countries dealt with in this volume. This certainly applies to the ideological impact of the crisis, which varied with the ideological undergirding of the regulatory status quo. The empirical falsification of the belief in the efficiency of unregulated markets hit hard in the United Kingdom and the United States, but the impact was milder in coordinated market economies such as Germany and France. In Switzerland, the crisis challenged a belief in self-regulation based on the historical legacy of self-reliance and individualism rather than the efficient market theory of liberalism. Behind the discredited British "narrative" of successful liberal opposition to the threat of an interventionist democratic state, convincingly described in the chapter on the United Kingdom, there lies the old issue of the balance between state and economy. The crisis of 2007/2008 appeared to have shifted this balance back towards the state.

The institutional changes following the financial crisis are the outcome of the preferences of and interactions between advocates and defenders of the status quo. The most visibly active reform agents were political actors. Their orientation and actions were influenced by several contextual factors, although it is difficult to generalize about them. It is an open question, for instance, whether elected members of parliament, party leaders, and politicians in high executive positions differed in characteristic ways in their reform orientation. Members of the European Parliament appear to have been more reform-oriented than, for instance, the European Commission; in countries where the government was forced by the crisis to take a stand immediately, parliamentarians became involved only at a later stage. It is plausible that the party composition of govern-

ments played a role. In Switzerland, the persistent dominance of conservative parties has shaped the response to the crisis. But there is no uniform relationship between the left/right orientation of a government and the strength of its reform orientation. In the United States, the Democrat Barack Obama at least initially did not stand up as strongly for regulatory reform as the Conservative David Cameron did in the United Kingdom. The country chapters suggest that institutional arrangements are another factor that shaped the policy response to the crisis, but again it is hardly possible to generalize about the kind of impact made by different institutional arrangements. In the United States, for instance, relations between the executive and the legislature played an important role in the gradual development of the Dodd-Frank Act. In the EU, the Commission acted as agenda-setter, the European Parliament pushed for reform, and the Council had to agree on compromise solutions. Political constellations, such as power relations between the governing party or coalition and the opposition, the imminence of a general election, and congressional power politics clearly influenced the course of national reform initiatives. Elections especially are situations that can be used to demand or reject change, and have been used in this way particularly in the United Kingdom. In the United States, the campaign promises of the incoming Obama government on health care reform tended to push financial market reform into the background for a time.

Since change in political power constellations follows its own dynamic, political factors are a source of contingency in shaping the details of regulatory change. Another source of contingency are institutional entrepreneurs, individual political actors with power and backing who make a specific reform issue their own project, as Elisabeth Warren and Paul Volcker did in the United States. In fluid situations with many actors pursuing different and often contradictory goals, a determined political actor can make a difference. To sum up, political actors were the most visibly important actor category in the process of planned regulatory change, but substantively their influence was highly contingent once crisis management had been provisionally successful.

Less visible than the influence of political actors has been that of central banks and supervisory agencies on the direction of the reform process. Agency reform in particular was affected by the distribution of regulatory competence between central banks and supervisory agencies. Most importantly, however, up until the crisis national central banks and supervisory agencies had close and cooperative relations with the financial industry and its organizations. It may not be surprising that in the United States and the United Kingdom, regulators, policymakers and the financial elite shared the regulatory ideology of efficient market theory. In the French case, this consensual outlook reflected a career pattern that started in the same institutions for the members of both elite groups.

However, elite consensus was not only based on a shared ideological outlook or career pattern, but also firmly rooted in national interests. In all countries represented in this volume, policymakers and regulators alike aimed to create, support, and safeguard a competitive domestic financial industry. Where the pre-crisis elite consensus had supported deregulation and light-touch regulation, it now motivated efforts to save that industry. In this process, a strong element of path dependency is involved. National central banks and supervisory agencies were not destined to become particularly active change agents; they may even have restrained radical change. The action orientation of national regulators and supervisors was also predominantly micro-prudential before the crisis, with bank solvency and investor protection the major goals. In the aftermath of the crisis, more emphasis was put on macro-prudential supervision and financial stability. Where central banks and supervisory agencies old and new become more explicitly responsible for financial stability, the attitude of these regulators vis-à-vis the financial industry may change.

Turning to international regulatory bodies (in the broadest sense), the G20 and the Financial Stability Forum had played the role of guardians of global financial stability already before the crisis. On the basis of this mandate they became, as noted in the preceding section, focal actors in the macro-process of regulatory reform. The international standard-setting bodies channeled the process of rule change towards those aspects of the financial system with which they had already been dealing before the crisis. Thus the Basel Committee started to tighten capital requirements for banks (chapter 10), IOSCO updated its standards for the supervision of securities markets (chapter 12), and the IASB became involved in the debate on whether fair value accounting had contributed to the crisis and needed to be changed (chapter 9). In this way, the pre-crisis structure of these international agencies, with their specific mandates, contributed importantly to the selectivity of the reforms.

The main opposition to institutional change is generally expected to come from those likely to be negatively affected. The ambitious reform plans voiced in direct response to the crisis were generally considered to be too restrictive by the financial industry. But the usual strategies of interest-group pressure on policymakers—the threat of a strike or the mobilization of public opinion against impending legislation—were not available in a situation in which the financial industry itself was seen as the culprit. The chapters in this volume provide only limited evidence on the extent and means of industry lobbying, and the levels at which it preferred to attack and did so most effectively. The industry, being itself negatively affected by the crisis, clearly recognized that something had to change. Since the financial industry is internally differentiated, however, reactions differed between sectors; this lowered the overall intensity of opposition

to reform. The intensity of opposition also differed between reforms. In the United States, for instance, the financial industry favored rather than opposed plans to monitor systemic risk, but it tried to ward off interventions that would restrict its freedom of action in the medium and long term. In Germany, savings and mutual banks that had not been involved in the trade with derivatives that proved to be "toxic" were particularly vociferous in protesting against the bank tax which the new restructuring law, which was supposed to address the problem of bank failures, included. Representatives of the finance industry were actively involved in the consultation process involving the regulation of capital requirements for banks, both at the BCBS and in the EU, but lobbying was not always successful. As Woll reports, hedge funds thought themselves exempt from regulation at first and woke up only belatedly to the threat; when regulation seemed inevitable, they cooperated with regulators, trying to make things easier on themselves (chapter 8). In Germany, the joint opposition of the banking association (BdB) and associations of savings and mutual banks failed to prevent the passing of the restructuring law or to change it significantly.

One effective defense for the financial industry was to use the inevitable information asymmetry between financial insiders and outsiders to paint a grim picture of the economic consequences of restrictive regulation: a credit crunch, loss of jobs in the finance industry, and slower growth. Critical views were expressed in official statements by interest organizations, but they were also conveyed through personal contacts in the social networks that existed between the financial elite and the political elite, mentioned especially in the chapters on the United States and the United Kingdom. In the United States, these contacts led to a coalition of financial and policy elites underlying the early preservationist approach to regulatory reform. To interpret such interaction as capture is too simple, however. Even without direct pressure from the financial industry, the national interest in competitiveness counteracted the political impulse to tighten regulation, producing a basic political ambivalence that reform opponents—and particularly the financial industry and its lobbies—could use. If expert industry representatives pointed out that planned regulation would affect economic growth and domestic competitiveness, rulemakers could not but listen to them. The interest of national governments that count on the jobs and tax revenue provided by the financial industry militated against more restrictive interventions.

Cognitive factors thus played a role in downsizing reforms. Planned change generally responds to the perception of the nature and the causes of the problem to be solved. While agreement was soon reached on the proximate causes of this financial crisis, efforts to identify its underlying mechanisms were confronted by the complexity of the financial system whose operation neither bankers nor economists, let alone politicians, had understood. Intervention targeted

the obvious causes of the crisis: the risk taking of bankers, the widespread use of certain types of derivatives, and large internationalized banks whose bankruptcy would force governments to bail them out with taxpayers' money. Attention also focused on issues of transparency, true to the teachings of economic theory that it is lack of information that causes market failures. But issues such as global economic imbalances, the financialization of the real economy, and the development of a culture of debt making were touched on only in fleeting asides in the reform discourse immediately following the crisis. It took the sovereign debt and currency crises of 2011 to focus attention on global imbalances, and on public as well as private debt (see, for instance, Bank for International Settlements 2011). The reforms triggered by the financial crisis did not even attempt to get at these causes. Not only were the reforms selective, but even the apparently radical initial reform ambitions were limited.

In democratic states, attention from the media and the general public is important for putting an issue on the political agenda. In the case of the 2007/2008 crisis, media attention was generally immediate and strong, while the reaction of the general public differed between countries. Where crisis management was sufficient to prevent massive immediate repercussions on employment, savings, and the value of money the public did not get angry and did not mobilize. In Germany, France, and Switzerland the effects of the bailout and its dire fiscal consequences, while highly publicized, were not immediately felt by the general public. Successful coping thus served to slow down the reform momentum. The general public was rather enraged by incidents that seemed to support the initial guilt attribution to bankers and financial institutions, as has been the case when the US supervisor, the SEC, filed fraud charges against Goldman Sachs. Only in the United States has public criticism led immediately to the formation of a grassroots organization by consumer groups and labor organizations, called Americans for Financial Reform, which was actively engaged in the regulatory reform process leading to the Dodd-Frank Act. It has taken until 2011 for an organization such as Finance Watch, initiated by a public statement of a group of European Parliament members in July 2010, to be formed at the international level (see www.finance-watch.org).

The most immediate effect of public opinion is on national politics, and it is also at the national level that domestic power politics plays a significant role in determining policy preferences. In international negotiations, national representatives tend to act as economic patriots, and a set of interests different from the one that determines domestic politics comes to the fore. Interests, of course, are subject to definition, and domestic politics, reflecting features of the national financial industry, does influence the definition of national interests. The German central bank, for instance, staunchly defended the interests of German

public banks and savings banks in negotiations on capital requirements in the BCBS and the EU. French policy preferences with respect to the EU regulation of hedge funds were similarly affected by the fact that UCITS funds, which had a stake in this regulation, were predominantly located in France (chapter 8). The policy preferences of the United Kingdom were influenced by the fact that, while British banks were not particularly big, the City as an international financial center is of great significance. Where the importance of the financial industry for the national economy is particularly large, there is more fear of the possible negative consequences of stricter regulation. In international negotiations, there is thus a tendency for national representatives to support reforms that would not hurt their own financial industry, but to oppose regulation that would. The result is a pattern of conflicting beggar-thy-neighbor strategies. Given the absence of even a single truly supranational agency with regulatory competence going down to the level of individual market actors, international negotiations tend to end in a so-called joint-decision trap: a situation producing compromises and lowest-common-denominator solutions (Falkner 2011).

A second difference between nations that affects preference formation in international negotiations—a country's position within the global geopolitical order—has been less evident after the financial crisis of 2007/2008. It was felt by big, export-dependent Germany, interested in continuing demand for its products, as well as by small Switzerland that had to ward off international pressure to change its mode of regulation, and particularly the rule of banking secrecy. The US policy process may seem to have been more inward-looking, an effect of the country's historical leading role in international finance and international financial regulation. However, the failure to have the US accounting standard setter FASB converge with the international accounting standard setter IASB (chapter 9) is a sign that this role might now be challenged.

The conditions of radical versus incremental institutional change

What can we conclude from the analyses presented in this volume with regard to the question hovering in the background of the case analyses: namely, under what conditions do big bang events, shocks or crises lead to radical change? What features of the event itself, and what features of the impacted field (or system) can dampen the impulse, and lead to merely incremental change? Even taken together, the network projects cannot answer this question, not only because

they deal with a single historical case, but also because the empirical analysis focuses inevitably on proximate causes. But a few observations can be hazarded.

It is common knowledge that reform energies are a limited resource that will soon be exhausted; reform advocates in fact soon warned that the reform momentum would slow down, and urged planners to make use of the crisis while it was still being felt. But what obstacles stood in the way of radical change? The usual answer points to the opposition of vested interests, the banking industry and its wealthy lobby. The explanation that emerges from the chapters in this volume is more complex, however.

One factor clearly dampened the impetus of regulatory reform: the failure of the feared collapse of the real economy to materialize. The suddenness of an event and the severity of its impact define it as a major crisis; the financial crisis came upon us suddenly, but the crisis management undertaken immediately and at all relevant political levels prevented an equally sudden, global economic breakdown. Perversely, the very fear of an economic collapse prevented more radical reforms by spurring attempts to prevent a meltdown of the financial system. Nevertheless, there have been some institutional changes. Media attention and the existence of an ongoing, submerged reform discourse were supportive factors, and so was at least potentially the shift from private to public regulation as a consequence of politicization. But the involvement of political actors in a process of institutional change works to the advantage of radical change only if politicians are firmly set on it. This, however, has not been the case: there was a gap between the early political reform rhetoric and concrete subsequent action. Not only did the outcome of reforms undertaken in direct response to the financial crisis of 2007/2008 lag behind the initial calls for a global and comprehensive change in financial market regulation, but the concrete reform ambitions of the political change agents, formulated domestically and in international negotiations, were modest in comparison with early reform demands.

The fact that reform ambitions were limited is not only the consequence of national interest in a competitive financial industry, elite consensus, and industry pressure. It also expresses a general unwillingness to call into question the institutional underpinning of modern capitalist democracies. A radical change involves getting to the root causes of a problem. The financial crisis was in fact only a symptom of a much larger problem situation, generated by the confluence of several developments impinging on today's wealthy democratic societies with their well-to-do middle classes: liberalization, tertiarization, financialization, and technological developments that substituted computers for human traders and offered new mathematical modeling techniques for risk assessment. A truly radical change of the financial system, and of its operation and importance for the economy, state budgets, and consumers would have required much more

than higher capital standards, leverage ratios, and resolution regimes for failing banks. A radical change of the financial system would have involved uprooting the very institutions on which modern, capitalist democracies are built. Among other things it would have required restricting the general dependence on credit, a dependence intricately connected with the inherent future orientation not only of financial markets, but of Western civilization. Whether they realized it or not (most did not), the enormity of the changes that would have been required to get at the root causes of financial crises of the type experienced in 2007/2008 made potential reformers shy away from the task. The strongest impediment to radical institutional change is their close integration with basic features of the societies in which they are embedded. Nothing short of a popular revolution would have sufficed to trigger such radical change, but popular uprisings of the kind we have seen shake the Arabic world in 2011 did not occur in 2009/2010, the period covered by the studies in this volume.

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