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The Politics of Central Bank Reform

Post-financial crisis institutional reform in the USA and UK

Harpal Singh Hungin

Thesis submitted for assessment with a view to obtaining the degree of Doctor of Political and Social Sciences of the European University Institute Florence, 31 August 2019

European University Institute
Department of Political and Social Sciences

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Examining Board

Professor Pepper Culpepper, Supervisor, formerly EUI/University of Oxford
Professor Dorothee Bohle, EUI
Professor David Coen, University College London
Dr Manuela Moschella, Scuola Naormale Superiore

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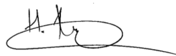

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Abstract

The prudential role of central banks has been greatly strengthened since the 2008 financial crisis. Yet domestic institutional dynamics have produced significant divergence in institutional reform. This thesis examines central bank institutional reforms in the United States (US) and United Kingdom (UK). These cases were selected due to variation in the institutional outcomes. The thesis controls for a variety of potential sources of institutional variation, such as the size of the financial sector, the impact of the crisis, changes of government, and central bank independence. Five propositions are suggested to explain how the institutional reforms are facilitated: by institutional constraints; by bureaucratic politics; thorough the self-interest of politicians concerned with electoral reward; in response to lobbying by the financial industry lobby; or in response to proposals from an epistemic community of regulatory experts. The case studies find that the number of political institutional constraints and the structure of bureaucratic power produce distinct modes of institutional change and explain the variation in institutional outcomes. The framework is applied to a comparative analysis of central bank reform in the US and UK. Prior to the 2008 US and 2010 UK general elections, the mains candidates and political parties attempted to deflect blame for the crisis by putting forward competing visions of institutional reform. This thesis argues that high veto possibilities and diffuse bureaucratic power in the US forced the Obama Administration to leave the existing architecture in largely place, while circumventing opposition by creating new institutional structures (institutional layering). In contrast, low veto possibilities in the UK facilitated institutional displacement; but by concentrating bureaucratic power, it also enabled the central bank to reshape reform in line with its own interests (institutional subversion). The findings provide new insights into the endogenous political and bureaucratic drivers of post-crisis administrative reform.

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I alone assume responsibility for any mistakes, omissions, errors, oversimplifications, misrepresentations of facts, or other shortcomings of this research.

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Acronyms

BoE	Bank of England
CFTC	Commodity Futures Trading Commission
DF Act	Dodd-Frank Wall Street Reform and Consumer Protection Act 2010
FCA	Financial Conduct Authority
FDIC	Federal Deposit Insurance Corporation
Fed	Federal Reserve
FIRA	Financial Institutions Regulatory Authority
FS Act	Financial Services Act 2012
FSA	Financial Services Authority
FSOC	Financial Stability Oversight Council
HMT	Her Majesty's Treasury
LOLR	Lender-of-last-resort
LSE	London Stock Exchange
NMC	National Monetary Commission
OTS	Office of Thrift Supervision
PRA	Prudential Regulation Authority
SEC	Securities and Exchange Commission
SIB	Securities and Investment Board
SRO	Self Regulatory Organisation

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Chapter 1. Introduction

1.1 Setting the scene

The 2007/08 financial crisis and subsequent global economic downturn was the most significant economic event since the 1929 Wall Street crash and great depression. The cost has been high in terms of lost productivity, lost jobs, and reduced investment. Large commercial entities ended up under public ownership, there was a loss in confidence of credit ratings, decline in asset values and paper wealth, disrupted credit flows, and enormous interventions by leading advanced economy central banks.

The collapse of Lehman Brothers in September 2008 changed the world of central banking stimulating a major re-think across advanced economies regarding the role of a central bank (Mishkin, 2012, p. 1). In the US and UK the prudential role of central banks has been strengthened significantly, with new regulatory and supervisory powers delegated to them in an effort to increase the stability of the financial system. Yet surprisingly little is known about the politics of central bank reform. This thesis addresses the politics of central bank reform by investigating the post-crisis institutional design of western advanced economy central banks.

Prime facie, western advanced economy central banks appear the great winners of post-crisis institutional reform. Their responsibilities, and therefore broad power, have increased significantly (Borio, 2011, p. 2) (Goodhart L. M., 2014, p. 281). Previously, the remit of these central banks seemed straightforward: Keep inflation in check through short-term interest rates. In response to the 2007/08 financial crisis central banks adopted their lender-of-last resort (LOLR) roles. However, as the crisis spiralled, so did central banks' balance sheets. The Federal Reserve Board (Fed) responded through buying government sponsored enterprise debt, mortgage-backed and Treasury-backed securities (Wessel, 2009, p. 266).

The Bank of England (BoE) began quantitative easing to purchase government debt. As the crisis intensified central banks deployed untested practices described as *"improvisation, bricolage, and...tacit Knowledge"* (Bowman, et al., 2013, p. 466).

Ultimately pursuit of financial stability has seen western advanced economy central banks' supervisory capabilities increase. The Obama Administration came to power with a mandate for significant institutional reform. The Dodd–Frank Wall Street Reform and Consumer Protection Act 2010 (Dodd-Frank Act) enhanced the US Fed's supervisory capabilities marking major shift in its mandate (Goodhart L. M., 2014, p. 281). Pre-crisis supervisory responsibility in the US was spread across several bureaux. The Fed, through its Reserve Banks, was responsible for the supervision of federally chartered banks, some state-chartered banks, and community banks. The Dodd-Frank Act created, amended and abolished a number of institutions involved in supervision and regulation. Most importantly it created the Financial Services Oversight Council (FSOC). The Council has wide-ranging power to seek all information required in order to assess systemic risk posed by a financial institution. The Treasury Secretary chairs the FSOC, ensuring a political principal has a strong element of control over regulatory agents. The Chair of the Fed holds a seat on FSOC. Once the Council designates a firm systemically important, the Fed enjoys sole supervisory authority. The reforms empower the Fed to foist higher capital standards on a private bank; halt its mergers and acquisitions; demand it get rid of divisions or force a bank into declaring bankruptcy. These powers extend to foreign entities with US-based subsidiaries. In order to gain these new capabilities the Fed had to accept new limits on its LOLR function, as well as the loss of conduct regulation.

In the UK, the Financial Services Authority (FSA) was disbanded and two new supervisory authorities created – the Prudential Regulation Authority (PRA) and Financial Conduct

Authority (FCA). Each operates under the veto power of the Bank of England (BoE). The Bank now oversees macro supervision of the financial system and its new Financial Policy Committee (FPC) can directly instruct the micro-supervisory arm. The Financial Services Act 2012 (FS Act) ratified the Bank's Governor with *"executive powers...chairmanship of committees setting monetary policy, system-wide financial rules, and the supervision of individual banks..."* (Giles, 2012). The FPC is chaired by the Governor of the Bank and consists of several internal and external Bank appointed experts, and the Chief Executive of the FCA. The Chancellor of the Exchequer does not have a vote on the Committee and HM Treasury can only send an observer to FPC meetings. The government blueprint stated the FCA is supposed to undertake conduct regulation of firms, whilst the PRA focuses on prudential regulation. In reality the FCA is the largest prudential regulator in Europe.

1.2 Puzzle

Since the 2008 crisis each of these central banks has assumed responsibility for intervention in the economy, including providing better economic outcomes, which, following previous crises had been the role of the state or state-controlled agencies. For example, after the Great Depression in 1929 there was another paradigm waiting in the wings in the form of *'socialist control'* by government (Goodhart C. A., 2010, p. 2). The US stimulated the economy using alphabet agencies, whilst the UK government created universal unemployment benefit. Like the 2008 crisis, the 1929 crisis was the result of a banking collapse that gave rise to a global economic depression. It was this event that resulted in the reconfiguration of financial regulatory institutions (Acharya, Cooley, Richardson, Sylla, & Walter, 2011, p. 48). Prior to the Great Depression banking regulation was relatively light touch. The 1929 crash was preceded by a prolonged period of financial innovation; large increases in wealth and inequality; and an increase in household debt (Acharya, Cooley, Richardson, Sylla, & Walter, 2011).

This same chain of events preceded the 2008 financial crisis. Yet, despite many contributing factors of the 2008 crisis being similar, this latest crisis has seen little advancement of state welfare. Instead, states have generally rowed back with central banks taking on more responsibility for economic interventions – state welfare has given way to a type of *'central bank-led welfare'*. Central bank policies have gained much greater salience and are now frequently front-page news stories (Bowman, et al., 2013, p. 455). This thesis seeks to add to the sparse body of literature examining the influence of central banks within capitalist societies and the politics of post-crisis supervisory reform.

Why, given central banks in the USA and UK were at least partly to blame for the regulatory failures that preceded the 2008 financial crisis, have they found their supervisory capabilities reinforced? Whilst one would not expect a significant decrease in independent central bank capabilities to be the outcome of post-crisis reform, it would be reasonable to have expected the crisis to undermine central bank claims to expertise in financial stability and supervision. Given this, a significant increase in central bank capabilities seems counter intuitive. Rather an increase in state-led intervention would have been expected. Furthermore, it is puzzling that central banks would willingly take on further supervisory and regulatory authority. Financial crises and bank failures always occur and are always followed by an institutional witch-hunt – often ending with some form of censure for regulatory authorities (Bell & Hindmoor, 2015). Supervisory responsibility is at best a zero-sum game. It will usually result in loss of prestige and reputational damage at different junctures.

1.3 Summary of the Argument

This thesis is situated within the literature on bureaucratic politics and veto players. This is because it addresses two theoretical areas. First, the thesis argues institutional outcomes that can be explained in part by the number of institutional veto points in a political system. Second, the thesis argues that the structure of bureaucratic power produces distinct modes

of institutional change. The thesis argues that high veto possibilities and diffuse bureaucratic power were key variables in the US, forcing the Obama Administration to leave the existing regulatory architecture in place, while circumventing opposition by creating new institutional structures (layering). By contrast, low veto possibilities in the UK facilitated institutional displacement; but by concentrating bureaucratic power, it also enabled the central bank to re-shape reform in line with its own interests (subversion). The theoretical framework is summarised below:

Bureaucratic Structures

		Concentrated bureaucratic power	**Diffuse bureaucratic power**
Institutional Constraints	**High veto possibilities**	*Absorption*	*Layering*
	Low veto possibilities	*Subversion*	*Displacement*

Finally, this thesis argues that throughout the institutional reform negotiations each central bank was able to powerfully influence reform outcomes as a result of the perception of central bank expertise. This formidable central bank expertise acted as a power resource that allowed the central banks to steer their political principals towards an outcome closer to the central banks' preferences.

The empirical chapters test the bureaucratic politics and institutional constraints propositions against the following alternative propositions: political interests; financial sector lobbying; and the influence of an epistemic community. The brief discussion below summarises why the thesis regards the alternative explanations as inadequate in explaining the institutional outcomes.

In respect of political explanations, the findings support the notion that political parties do not care about policies but more simplistically only care about gaining office (Wittman, 1973, p. 495) (Dunleavy, 1991, p. 118) (Roemer, 2001, p. 7). The preferences of political actors in both case studies are critical to the enactment of institutional reform. Thus the model could be refined to account for policy preferences of political elites seeking to propose the policy preference that best maximises their party's utility (Wittman, 1973, p. 495) (Roemer, 2001, p. 7). However, there is a major shortfall in the political proposition as it is explained by the literature. It assumes that politicians conceive of institutional reform as a tool for electoral victory and then implement their preferences over agents hierarchically in order to reap the electoral rewards in the future. Nether the Obama Administration or Conservative-led coalition was able to impose its preferences directly and circumvent the preferences of other actors.

Turning to the financial services lobbying proposition, the results are significantly different in the US and UK cases. This thesis suggests that the impact of public opinion made politicians significantly less responsive to the concerns of large banks. In the UK the banking sector was unable to influence the reform process. Yet in the US case the community banking lobby was relatively powerful. Much of the variation in the US institutional reform outcome is a result of action or inaction by community bank lobbying. The diversity and factionalism of the US banking sector provided an opportunity to influence the institutional outcomes. The findings in relation to financial services lobbying should be qualified by an acknowledgment that interviewees may have under or over represented the extent of financial industry lobbying in each case.

Finally, this thesis rejects the epistemic community proposition. Both the Fed and Bank adopted macroprudential policy in response to prevailing domestic conditions rather than

due to the influence of or shared belief amongst an epistemic community. The concept of macroprudential supervision is not new. It was simply ignored by large swaths of the international central banking community. The crisis created a use for a pre-existing idea, presenting it as a missing piece of the central banking toolkit. There is no evidence that suggests micro prudential institutional reform was the result of an epistemic community promoting any ideas. Indeed, different types of agencies in many jurisdictions conduct micro supervision across the UK, Eurozone and USA.

1.4 Research Goals and Questions

This thesis addresses the expansion in macro and micro supervisory capacity of Western advanced economy central banks post-financial crisis. It focuses on the USA and UK as case studies. The central banks in these jurisdictions oversee two of the most important financial centres in the world. The institutional reforms that altered the Bank of England and Federal Reserve's capabilities are enshrined in the Dodd-Frank Act 2010; and the Financial Services Act 2012. This thesis is not a study of a legislative process. Rather, it is a study of the interactions between politicians, bureaucratic actors, and the financial services industry that explain the post-crisis the institutional design of central banks. This approach allows for a thorough examination of actor preferences and an analysis of how and why different actors altered their strategies to accommodate prevailing conditions.

In particular, this thesis explains the structure of delegation (the location of new macro and micro prudential powers) and the terms of delegation (the extent of political or administrative oversight). The main research question is: *How and why has post-financial crisis central bank institutional design taken the particular form it has in advanced Western economies?* The sub-questions that are addressed by this thesis are:

- *What were the institutional reform preferences of the actors involved in the institutional reform process?*
- *How did central banks try to shape the outcome of the institutional reform process?*
- *Which actors had the most influence over institutional reform process?*
- *How did advanced economy central banks operate prior to the financial crisis?*

This project sheds light on the as yet insufficiently explored role that western advanced economy central banks have played in the politics of central bank reform. In doing so the thesis forms testable propositions to account for the institutional outcomes observed in the US and UK. Central bank activism sits uncomfortably with assumptions made in much of the Varieties of Capitalism literature from Hall and Soskice (2001) onwards. This literature suggests it is private banks or stock markets that act as the persistent institutional differentiators defining the identity of market economies. This thesis seeks to bridge this gap in our knowledge and address the concept of influence exercised by central banks.

Having considered what this thesis attempts to achieve, it is important to acknowledge the limitations. This thesis does not address all the possible effects of central bank reform. Instead the research focuses specifically on the process of post-crisis institutional reform in the US and UK. This research does not fully address the normative aspects of post-crisis economic policy as this is beyond its scope. Finally, this research does not attempt to prescribe a best practice model for financial regulation; instead it seeks to deepen understanding of developments that have already occurred.

1.5 Research methodology

The methodological framework employed throughout this research is derived from the existing literature on central bank reform and bureaucratic behaviour. This research adopts

a case study approach used in conjunction with process tracing and elite interviews. The within case analysis controls for elections and party, but provides several observations of institutional change. These approaches are compatible with each other and contribute to methodological triangulation, helping to overcome their individual weaknesses. The dependent variable is measured through the supervisory architecture enshrined in the Dodd-Frank Wall Street Reform Act 2010 and Financial Services Act 2012. This legislation ended a rethink of the role of central banks as part of re-shaping banking supervision. The independent variables are actor preferences. The casual mechanisms consist of influence; policy expertise; and institutional factors.

1.6 Chapter summary

This thesis is structured as 7 chapters. Chapter 2 provides a review of the academic literature, outlines the theoretical framework, and development of the propositions that are tested throughout the empirical research. The logic of the explanations outlined in this introductory chapter and the importance of the institutional constraints are set out in greater detail in this chapter.

Chapter three provides a discussion of the methodological approach deployed throughout this research. The dependent variable is the institutional reform of advanced western economy central banks. The independent variables that explain this outcome are competing actor preferences. These variables explain the variation in the dependent variable over the 2 case studies. The empirical research relies on a combination of primary and secondary analysis. Primary sources include government documentation, press releases, and speeches, as well as 42 elite interviews with private banks, central bankers, Parliamentarians, government officials and observers with intimate knowledge of the institutional reform negotiations. Secondary sources include articles from trade journals, legal commentary,

newspaper articles, and the research of other academics across the disciplines of economics, business management and social science.

Chapter four explains the evolution of the roles bot the Federal Reserve and Bank of England in banking supervision and regulation over time. This chapter provides the necessary historical context in order to prevent misunderstandings of the explorations that follow in proceeding empirical chapters.

Chapter five begins the primary empirical research that concerns this thesis, with a case study of the US Federal Reserve and its increase in capabilities post-financial crisis. It charts the negotiations between the key actors involved in the architectural reforms to banking regulation that were formalised by the passage of the Dodd- Frank Wall Street Reform Act 2010.

Chapter six continues the empirical research of this project by examining the increase in capabilities of the Bank of England in the UK following the outbreak of the crisis until the formal passage of the FS Act 2012.

Chapter seven concludes this thesis by bringing together the findings of the previous two chapters in a comparative analysis. It assesses the similarities and differences in explanations for change across the two jurisdictions studied. In doing so it addresses the relative influence of each central bank and its authority within its polity. This chapter also concludes the thesis by providing a summary of the findings and their contribution to the political economy literature on central bank reform.

Chapter 2. Literature Review, Propositions and Alternative Explanations

2.1 Introduction

Since the financial crisis, banking regulation and supervision across Europe and the US has undergone a series of profound institutional reforms aimed at strengthening the long-term stability of the financial system. Yet these reforms have proven to be highly contested, giving rise to important differences in institutional design of advanced economy central banks – as the institutional locus of post-crisis banking regulation and supervision.

This chapter reviews the theoretical foundations that underpin this thesis and the analytical framework that this thesis utilises to explain the outcomes of post-crisis central bank institutional reform. This framework is then tested throughout the empirical chapters that follow.

2.2. The Economics of Supervisory Architecture and Central Banks

Before examining the political economy literature on central bank reform the first section outlines the public policy arguments for central bank involvement in macro and micro prudential regulation. This is important for understanding the technical nature of arguments that actors in the case studies refer to.

2.2.1 Micro and Macroprudential Supervision

Advanced economy central banks were best known, pre financial crisis, as monetary policy experts with responsibility for managing liquidity, acting as a lender-of-last-resort (LOLR), and preventing and managing banking crises. However, these responsibilities are macro-level issues and for the most part, in the pre-crisis orthodoxy, they were conducted in cooperation with government agencies that held responsibility for micro prudential

supervision of private banks. Indeed, the main institutional innovation in the decade prior to the financial crisis was the shift towards a *'tripartite'* system of banking supervision (Eijffinger & Masciandaro, 2011). In the UK for instance, responsibility for the supervision of individual financial institutions (micro prudential supervision) was taken out of the hands of the central bank, and given to a separate financial supervisory agency in 1998. The recent crisis has forced a fundamental re-evaluation of central bank capabilities, with many blaming their narrow focus on inflation for ignoring the development of unsustainable financial imbalances.

Since 2010 central bank mandates have therefore been expanded to include new responsibilities for macroprudential regulation. Macroprudential regulation is concerned with reducing systemic risks to financial stability through the use of new countercyclical policy instruments (Dincer & Eichengreen, 2011; Goodhart C. A., 2011; Goodhart C. A., 2010; Dalla Pellegrina, 2013). It is perhaps best conceptualised as segmenting monetary conditions across different segments of the real economy, such that a wedge is placed between general interest rates and the monetary condition of a specific area of the economy. The US Federal Reserve, European Central Bank (ECB) and central banks across Europe have been delegated additional macroprudential powers and new decision making structures have been established to oversee these.[1] The general consensus with regard to macroprudential capabilities, amongst central bankers, has been that macroprudential policy is fraught with incentives for political interference, thus only a highly independent organisation, such as an advanced economy central bank, could discharge it effectively (Mishkin, 2012, pp. 11-12).

[1] For example, the Financial Stability Oversight Council in the US, the Financial Policy Committee in the UK, the European Systemic Risk Board in the Eurozone, and the Financial Regulation and Systemic Risk Council in France.

However there is no such consensus regarding the precise location of micro prudential supervision. The European Central Bank (ECB) distinguishes between three main supervisory models: (i) sectoral: each sector (banking, securities and insurance) is supervised by one authority; (ii) 'twin peaks': responsibilities are allocated on the basis of the supervisory objectives, with prudential supervision and conduct of business/market regulation attributed to two different authorities; and (iii) single authority: all the supervisory functions are allocated to a single authority, which covers both prudential supervision and investor protection (ECB 2010). Although many large economies, including the UK, France, Italy and the Netherlands, have moved towards the so-called 'twin peaks' model, the single authority model remains dominant across Europe.[2] Even within twin peak systems, important differences exist regarding whether micro supervision is fully integrated into the central bank or located in a separate subsidiary or independent agency. Considerable variation in institutional design between countries therefore exists.

It is important to define clearly the distinction between micro and macroprudential supervision. Micro prudential supervision refers to the day-to-day supervision of individual private banks. For example, regulating individual firm balance sheets. Macroprudential supervision refers to oversight of the entire financial system within a national economic context. There has been much debate within the field of economics regarding the role of central banks combining monetary policy-making with this macroprudential role, alongside the responsibility to discharge micro prudential supervision (Masciandaro, 2012, p. 115) (Blinder, 2010).

2.2.2 Pro-Micro-Supervision and central banking

The pro-micro supervision view refers to central bank involvement in micro-level supervision. There are a number of arguments that have been made within the economics

[2] The 'twin peaks' model has recently been adopted in the UK, France, Netherlands, Italy, Belgium, Portugal; while the single authority model prevails across the rest of the EU (ECB 2010).

literature that suggest this integrated format may be the best policy option. First, there are informational advantages to integrating both capabilities within a central bank and economies of scale can be better achieved by bringing supervisory and monetary policy under the same roof (Bernanke, 2011) (Herring & Carmassi, 2008, p. 65) (Dincer & Eichengreen, 2011, p. 2) (De Grauwe, 2007) (Masciandaro & Quintyn, 2009, p. 5) (Klompa & de Haana, 2009, p. 322). In addition, it has been argued that the technical expertise of those recruited by central banks are better equipped to independently analyse micro prudential data (Apinis, et al., 2010, p. 7). Essentially having greater levels of information analysed by individuals with both more appropriate and higher skillsets provides for more efficient and successful micro prudential supervision. As a result, it is argued that having both macro and micro prudential supervision housed under the roof of a central bank is the most efficient method of achieving a strong supervisory architecture, lending itself to increased financial stability.

2.2.3 Anti-Micro Supervision and central banking

Some of the economics literature also suggests that central banks expanding their remits beyond macro-supervisory functions and into the realm of micro-supervisory capabilities can cause a risk to the maintenance of financial stability. A number of arguments against central banks taking on micro prudential regulatory responsibilities have been posited within the economic literature.

First, there is the potential for a moral hazard issue to arise. If the supervisor has the ability to manage liquidity, this incentivises regulated banks to engage in more risky behaviour (Masciandaro, 2007, p. 287). This increase in moral hazard presents a serious threat to financial stability. In addition, there is a conflict of interest issue that arises for the central bank that also undertakes micro-level supervisory tasks.

Second, the reputational risk when the micro prudential supervisor is also the monetary policy-maker is high, and therefore can negatively impact the behaviour of the central bank. Loannidou (2005) highlights this in his case study of the US Federal Reserve Bank (Loannidou, 2005, p. 82). Banking crises are inevitable and the micro-supervisory institution receives a degree of blame and has its expertise questioned as a result. Micro prudential responsibility can only result in a net loss for the central bank. When both functions are housed within the central bank, its expertise in monetary policy-making may also be questioned impacting its credibility in financial markets – rendering its core function obsolete. There is also the potential for conflicts to arise between the monetary policy and micro prudential supervisory arms of a central bank (Llewellyn, 2004). It has been argued by economists (Cukierman, 1992; Brimmer, 1989; Heller, 1991) that central bank participation in banking regulation should not be normal practice, based on the notion that a central bank with responsibility for preventing systemic risk is more likely to loosen monetary policy on occasions of economic difficulty. In times when the macroeconomic outlook is weak, there are very real possibilities of banks of all sizes experiencing soundness issues (Blinder, 2010, p. 131). The micro-supervisory division of a central bank would suggest disciplining the banks whilst the macro-economic arm would argue for regulatory forbearance, as the economy would require increased support through bank lending (Blinder, 2010, p. 131). That said, there would still be conflict between the central bank and an agency that undertook micro-supervision in such a scenario, thus it may well be the case it is more beneficial to have the debate within one institution rather than protracted inter-bureau rivalry.

Third, the notion of capture of a central bank by the regulated industry. The central bank may use its discretion in liquidity capabilities to satisfy the requirements of the regulated industry, as opposed to fulfilling its social welfare function in terms of financial stability.

Boyer and Ponce (2011) argue that the capture of a central bank is the most serious type of regulatory capture as the banking industry is likely to place more emphasis on capturing the most powerful actors (Boyer & Ponce, 2011).

Last, arguments of excessive bureaucratic power have been used against the idea of centralising both macro and micro prudential capabilities within an independent central bank. As an independent central bank's capabilities and influence increases, so does its unaccountability to elected officials. (Goodhart C. A., 2010) (Dincer & Eichengreen, 2011). This would result in technocratic policy-making with little accountability or transparency to the public.

The review of the regulatory economics literature shows that there is no consensus regarding the ideal capabilities of central banks or institutional architecture regarding financial supervision. Delegation theory provides conflicting views on the costs and benefits of augmenting the power of central banks. The arguments rehearsed above can be applied to any institution that undertakes both macro and micro prudential supervisory tasks – they are not necessarily specific to central banks. They are all analytical arguments that can be expected to surface during negotiations regarding post-crisis central bank institutional reform. In short, functional explanations in isolation provide little guide as to why different countries make particular institutional choices. It is clear that greater focus must be placed on the agents involved in decision-making. How can this consolidation trend of supervisory capability within Western advanced economy central banks be explained? It is clear that it cannot be rationalised via a traditional cost-benefit analysis of different architectures. Policy decisions by definition are intentional actions by actors with an interest in achieving specific ends. This is the only way in which we can explain why and how increases in central banks' supervisory capabilities post-financial crisis has taken place. In order to do this it is

important to examine the political economy literature focusing on the role of political actors in the re-design of regulatory architecture.

2.3 The Political Economy of central bank reform

The remainder of this literature review is divided into two main sections. The first reviews the literature that informs the propositions and model this thesis tests. The second section explores the literature that provides potential alternative explanations.

2.3.1 Building an institutional account of central bank reform

Much has been written about central bank reform from the perspective of ideas, epistemic communities, partisan politics and financial lobbying. Surprisingly, there exists no bureaucratic politics centred account of central bank reform. For the most part bureaux are viewed as silent, the implication being that they are subservient recipients of reforms imposed upon them by their political principals.

This thesis develops a framework that considers institutional design as an outcome of intentional choices, shaped by a process of both institutional constraints and bureaucratic bargaining. This is achieved through developing an ACI approach. Such an approach should shed light on the politics of central bank reform; the preferences of the key actors involved; the institutional rules governing the reform processes; and the strategies and bargains involved in reaching agreement. The following section outlines the basis for doing so.

ACI provides an endogenous account of institutional change that places strategic and interpretive agents at the heart of institutional analysis (see Bell 2011; Mahoney and Thelen 2010; Scharpf 1997; Streeck and Thelen 2005). Its starting point is that institutions are not simply adjusted to meet functional preferences; rather, exogenous pressures create spaces for institutional contestation within which functional preferences are themselves challenged. These spaces are filled by political and bureaucratic actors that compete and

bargain to redesign institutions to further their own interests. ACI uses simple game theoretic concepts to disaggregate institutional reform into a series of strategic choices based on the preferences, capabilities and strategies of the players involved (Scharpf, 1997, pp. 43-5).

2.3.2 Institutional constraints

Institutions can be broken down into ‘political institutions’ and ‘economic institutions’. Political institutions include the political regime, the electoral system, the strength of political parties, and the number of veto-players in the political system. Political institutions affect institutional reform decisions directly through vetoes on the policy decisions of the executive, and indirectly through elections rendering policy-makers accountable to the electorate on a regular basis. Economic institutions include the structure of the financial system, central banks, and regulatory structure. Economic institutions alter behaviour by affecting the distribution of wealth and influence among economic interest groups.

Institutional veto players refer to individual or collective actors whose agreement is necessary for policy change to take place (Tsebelis 1999, 2002) (Gehlbach and Malesky, 2010) (Cox and McCubbins, 2001). Veto player theory states that the configuration of veto points in a political system determines the set of possible outcomes that can replace the status quo (known as the ‘winset’) (Roemer, 2001). All else being equal, the higher the number of veto players, the smaller the ‘winset’ available; it follows that policy stability is therefore high. Applied to real world political systems, the theory assumes that presidential systems, characterised by a separation of powers, have multiple constitutional veto points (in the US this includes the President, Congress, Supreme Court, and the States). By contrast, Westminster-based parliamentary systems, based on the fusion of executive and legislative power, usually have a single institutional veto player (Parliament).

Veto power is also linked to political parties, for example the number of political parties that must agree for policy change to happen. It follows that a single partisan veto player exists where a single party commands a legislative majority, but a coalition government (in a parliamentary system) or divided government (where different parties may control different branches of government, as in a presidential system) produces multiple partisan veto players. While institutional veto players are fixed, the importance of partisan veto players will vary over time depending on levels of partisan polarisation, defined as high levels of ideological distance between parties and high levels of homogeneity within parties (McCarty, Poole, & Rosenthal, 2015). Where multiple partisan veto players exist, it follows that the higher the level of partisan polarisation on an issue, the lower is the likelihood of policy change because agreement will be more difficult to achieve.

More recent studies suggest that partisan polarisation is central to understanding the nature of post-crisis reform (Carpenter, 2010; McCarty and Poole and Rosenthal 2015; Hacker and Pierson, 2016). Evidence from the US shows that the two main parties are deeply polarised, leading them to veto each other's policy initiatives and contributing to the institutional 'strangulation' of regulatory reform (Carpenter 2010). By contrast, partisan preferences on financial regulatory reform in the UK are less well understood. Yet recent studies do point to the development of a broad cross-party consensus on the need for wholesale banking reforms to restore financial stability (Bell and Hindmoor 2015). On this basis, it is proposed that institutional constraints are a key variable in explaining institutional variation in central bank reform across case studies.

In the event of many veto players, institutional change is more likely to take the form of *'layering'* (Thelen 2003). This occurs when existing institutional structures remain largely in place due to political opposition and/or because bureaucratic actors disagree over how they

should be reformed. In response, political actors simply create new institutional rules and structures instead. These changes are incremental in nature, but over time they can produce substantive changes in outcomes as actors alter their behaviour in response to the addition of new institutions within an existing institutional framework.

P_1. *Political systems with fewer institutional veto points will find it easier to enact institutional reform, while in states with federal systems or higher political party fractionalisation institutional reform will take the form of layering.*

2.3.3 Bureaucratic Politics

Bureaucratic politics also shapes institutional change, creating space for non-constitutional veto points. Weber (1958), views bureaucracies as having a "rational character" in which specific jurisdictions apply to bureaux and capabilities are dispersed hierarchically. Though bureaucratic decision-making portrays a rational character, this does not mean that all aspects of human nature can be ruled out of bureaucratic politics, as Weber states: *"Every bureaucracy seeks to increase the superiority of the professionally informed by keeping their knowledge and intentions secret"* (Weber 1958).

Graham Allison first developed the model of bureaucratic politics focused on explaining foreign policy decisions, and developed three models of analysis for understanding decision-making (Allison, 1971). First, the rational actor model. This stems from classic rational choice theory and describes policy decisions as a cost-benefit analysis by state actors. The rational actor model predicts that governments are unitary, identify the problem, search for and discuss policy options and alternatives, perform objective cost-benefit analyses of the options, and then proceed with the option that maximises the utility of the state (Allison 1971).

Second, the organisational process model emphasises the influence of organisational mission and organisational essence. Organisational essence and standard operating procedures refers to the range of available options, how the government approaches the problem and the structure and constraints within which leaders make decisions (Allison 1971).

Finally, the third model proposed is known as the governmental or bureaucratic politics model. It introduced the concepts of bureaucratic role, position, and organisational mission and essence into the calculus of decision-making. The model predicts that actors will prefer policy options that fulfil their bureaucratic role and augment their power and influence in the decision-making process. Actors' policy positions are determined largely, but not exclusively, by their position within government and associated bureaucratic role (Jones 2010). Allison applied Miles' Law of "where you stand depends upon where you sit" to describe the relationship between bureaucratic role and policy preferences (Miles, 1978, p. 399) (Jones 2010). The model suggests that government action is political and not the product of economic cost-benefit analysis. Allison (1969) described the nature of the political competition at the heart of bureaucratic politics:

> *"The decisions and actions of governments are essentially intra-national political outcomes: outcomes in the sense that what happens is not chosen as a solution but rather results from compromise, coalition, competition, and confusion among government officials who see different faces of an issue; political in the sense that the activity from which the outcomes emerge is best described as bargaining"* (Allison G. 1969, p. 708).

For Allison political competition is crucial to bureaucratic politics, arguing, *"each player pulls and hauls with the power at his discretion for outcomes that will advance his conception of national, organisational, group, and personal interests"* (Allison 1971, p. 171).

This is true of central banks and institutional reform negotiations, as this thesis argues; these negotiations are often played out in secretive environments. Negotiating a bargain is reliant on one actor making use of its advantage, for example informational power or perception of power and expertise (Allison & Halperin, 1972, p. 52). Perceptions of power amongst actors are important in determining outcomes, though power is a difficult concept to measure.

It is assumed that bureaucratic organisations, like central banks, actively seek to shape their policy environment to enhance their power, status or autonomy (Adolph 2013; Bendor *et al* 1985; Miller and Moe 1983; Niskanen 1971). This can be achieved by expanding discretionary control over innovative policy work or 'hiving off' tasks which expose them to reputational risk (Dunleavy 1991). Knill (1999) argues that the ability of governments to implement institutional change 'from above' is determined by the concentrated or diffuse nature of bureaucratic power. Where powers are concentrated and centralised within a single agency, bureaucrats are likely to wield greater influence in steering reform in line with their interests (Knill 1999, p. 116). This is because bureaucratic actors can exploit their monopoly control of important informational resources, such as technical knowledge and policy expertise, to lobby political actors for or against particular changes (Huber and Shipan 2002). By contrast, if bureaucratic power is fragmented and diffused across multiple organisations, bureaucratic agencies are likely to be less effective in steering institutional change. In this situation there is unlikely to be agreement amongst different agencies about the desirability of different reform options; rather, each will simply seek to defend their own bureaucratic 'turf' from potential encroachment (Gains and John 2010). In a context of

bureaucratic competition, individual agencies may therefore strive to resist change, but they are unlikely to wield sufficient influence to reshape reform in line with their own organisational interests.

While bureaucratic motives are likely to be mixed, the assumption is made that actors pursue bureau-shaping strategies of agency *'subversion'* in an effort to further these interests. In the UK bureaucratic power at the time of the institutional reform negotiation was concentrated, with the Bank of England and FSA as the only regulatory bureaux. In the USA the regulatory authority was fragmented across over 12 agencies. Thus the cases of the USA and UK appear to show regulatory fragmentation has an impact on the institutional reform outcome. As a result the following proposition is derived.

P_2. *If bureaucratic authority is concentrated, central banks are likely to wield greater influence over the institutional reforms, moulding them in line with their own preferences. Whereas, if bureaucratic authority is diffused across multiple agencies, central banks will be less influential in shaping institutional reforms in line with their own preferences.*

The interaction of institutional constraints and bureaucratic power produces distinct modes of institutional change. Modifying the typology proposed by Mahoney and Thelen (2010), a matrix of institutional constraints (high or low veto possibilities) and bureaucratic structures (concentrated or diffuse power) yields four possible outcomes. The first mode involves institutional change in a context with low veto possibilities and diffuse bureaucratic power. In this situation, political actors will face few obstacles from institutional or partisan veto players, giving them considerable scope to redirect existing institutions 'from above' towards new goals, functions and purposes. In addition, as bureaucratic authority is fragmented, the capacity of individual agencies to either resist or reshape reform in line with

their interests will be limited. As a result, institutional reform is likely to be transformative in scope, giving rise to the abolition of existing institutions and the creation of news ones. This is labelled institutional change through ‘displacement’. By contrast, if bureaucratic power is concentrated, we would expect powerful bureaucratic actors to play a more important role in steering the reforms by leveraging their monopoly control of valuable bureaucratic resources (Knill 1999). Even in the absence of political veto possibilities, powerful agencies may be able to exploit ambiguities and unintended consequences in the reform proposals, enabling them to circumvent features that clash with their interests and to steer outcomes to match their organisational goals (Quack and Djelic 2005). Consequently, significant institutional change will take place, but the reforms may be interpreted and implemented in ways that were not originally intended. This is labelled as institutional ‘subversion’.

The third mode involves institutional change in a context of high veto possibilities and diffuse bureaucratic power. Here political actors will face significant resistance from institutional and partisan veto players, thereby limiting the scope and likelihood of change. Bureaucratic fragmentation will also limit the influence of individual agencies. By deliberately cultivating political opposition and contestation over institutional reform, agencies may be able to resist or delay changes to existing institutional structures. Yet inter-agency rivalry will limit their capacity to prevent the creation of new institutions or to steer reform in a particular direction. Faced with both political obstacles and bureaucratic infighting, institutional change is likely to take the form of ‘layering’ (Thelen 2003). This occurs when political actors leave existing institutions in place, but try to circumvent opposition by creating new institutional structures, rules or processes on top or alongside them. A final mode would be expected where political actors attempt reform in a context of high veto possibilities and concentrated bureaucratic power. As above, political barriers to

change would be high, but to the extent that incremental reform was possible, this would also be subject to significant reshaping by powerful bureaucratic interests capable of both resisting amendments to existing structures and blocking the creation of new ones. Institutional change would therefore be characterised by absorption: political reform efforts would be effectively stifled by bureaucratic actors and/or institutional constraints, resulting in a largely symbolic act of reform with little or no effect on policy outcomes.

Table 1: Summary of potential outcomes as a result of interactions between institutional constraints and bureaucratic structures (adapted from Mahoney and Thelen 2010).

		Bureaucratic Structures	
		Concentrated bureaucratic power	**Diffuse bureaucratic power**
Institutional Constraints	**High veto possibilities**	*Absorption*	*Layering*
	Low veto possibilities	*Subversion*	*Displacement*

2.3.4 Central Bank Influence

Central banks' influence derives from three sources. First, they control powerful policy instruments, such as interest rates, which directly impact on economic conditions and indirectly on the electoral prospects of incumbent governments (Masciandaro 2012). Second, bureaucracies enjoy informational advantages through their monopoly of policy-specific knowledge and technical expertise, much of which is supplied by regulated entities (Bendor *et al* 1985; Huber and Shipan 2002). The impact of expert knowledge is not only important within the context of an epistemic community. It can be an important element of influence and power within the domestic political arena. This thesis contends that the central banks involved in these cases were bureaucrats attempting to serve several conflicting public policy and political interests in an effort to maintain if not enhance their

positional power in their domestic polities. Of the different relationships that may exist between actors involved in financial supervisory reform, there is a focus on the role of expertise because *"information is important with regard to the role of power"* (Cutler et al. 1999a, 347). Third, influence derives from constitutional autonomy. Not only does this provide scope for policy discretion, it also enables bureaucratic agents to accumulate reputational power through their permanence, competence and legitimacy (Carpenter, 2001).

2.3.5 Expertise

Expertise underpins the influence of actors. A key question is what constitutes expertise? Carpenter (2001) suggested that expertise and agency independence are closely linked, stating: *"Autonomous agencies must demonstrate uniqueness and show that they can create solutions and provide services found nowhere else in the polity"* (Carpenter, 2001, p. 5). Another interpretation is specialised understanding of the mechanisms by which to achieve a given outcome (Callander, 2008). Central banks tend to place significant value on recruitment of domain relevant expertise (Franzese, 1999, p. 681) (Goodhart C. A., 2010). For example, they recruit from graduates of predominantly quantitative disciplines (natural and social sciences), as well placing large value on doctoral degrees (Fox, 2014).

Political science has a longstanding interest in expertise and their impact upon decision-making by political elites. It is helpful to define what characteristics distinguish experts from non-experts. First, experts tend to view information as part of larger patterns, whilst non-experts will view information in isolation (Krosnick, 1990, p. 3). Experts will present information '*at a deeper and more principled level in terms of broad categories"*' in contrast non-experts will represent information at a more superficial level (Krosnick, 1990, p. 3). Experts will tend to adopt a more analytical approach to information – both quantitatively and qualitatively. Non-experts will tend to develop strategies without thinking through the

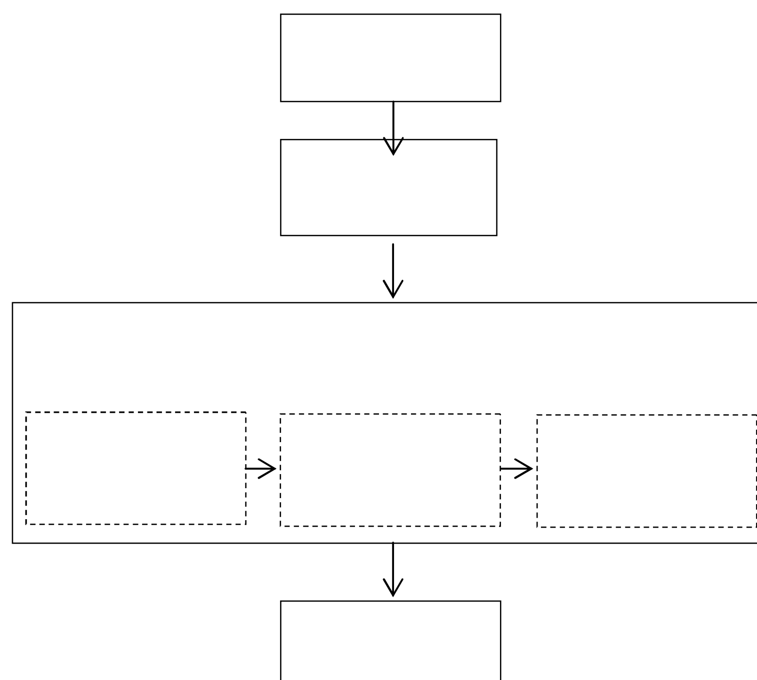
technical consequences or impact (Krosnick, 1990, p. 3). Krosnick argues that experts tend to benefit from greater self-awareness as compared to non-experts, thus are able to judge when decisions may need to be re-considered (Krosnick, 1990, p. 3). Finally, experts possess more domain relevant knowledge and are able to acquire new domain relevant knowledge quickly (Krosnick, 1990, p. 3).

Expert knowledge itself can be separated into three dimensions: technical refers to very specific knowledge about the field such as details on operations and laws; process refers to information on the routines and specific interactions; and explanatory knowledge refers to the subjective interpretations of relevance, rules and beliefs. It is a given that central banks contain high levels of financial expertise and knowledge. What varies across different polities is the level of regulatory expertise held by individual institutional actors. For example, the UK's HM Treasury is not compiled from technical financial experts who are equipped to challenge the central bank's numerous economics doctorates (Culpepper & Reinke, 2014, p. 442). In contrast the US Treasury Department, from the position of Secretary downwards, is staffed with former industry experts and economics PhDs.

In governance, the "*control over knowledge and information is an important dimension of power and … the diffusion of new ideas and information can lead to new patterns of behaviour and prove to be an important determinant of international policy coordination"* (Haas 1992, 2-3). Sinclair (2000) suggests it is precisely this transformation of authority that has wide ranging effects in the global governance of finance because *"the reinvention of authority … narrow[s] what is understood as the legitimate sphere for future public policy interventions."* Similarly, expert information may also be used to exclude actors from the policy process, bringing up issues relating to legitimacy and accountability of these actors.

To capture these important dynamics at each stage of the reform process, the central bank reform process is disaggregated into a series of sequential and nested negotiations played out between government principal and central bank agent. Understanding how the resolution of each negotiation influences the strategies available to players in subsequent games provides a systematic approach to analysing the causal factors of the institutional reform. The analytical framework of disaggregated negotiations is outlined below

Figure 1: Analytical framework for assessment of institutional reform negotiations



2.4 Alternative explanations

The findings based on the framework developed are compared to the outcomes expected based upon the alternative bodies of literature. These competing explanations are explained in this section.

2.4.1 Political Explanations

Partisan theory states the political ideology of the incumbent party provides the causal mechanism with which we can make links to preferences of governments for particular macro-economic policies or institutional settings (Alesina & Rosethal, 1995) (Garrett, 1998)

(Quaglia, 2008b) (Way, 2000). Partisan theory has been used to explain causal factors that contribute to central bank independence (CBI) in advanced economies (Way, 2000).

Academics have argued providing a central bank with greater autonomy provides benefits for government, without governments having to directly incur costs from mistakes (Masciandaro, 2012, p. 119) (Way, 2000, p. 197). The literature suggests governments' ability to pursue partisan macro-economic goals is contingent on the organisation of central banks (Way, 2000, p. 201). Many believe central banks hold preferences that differ significantly from those of political actors, for example they tend to favour lower inflation rates, along with a more stable long-term macro-economic environment (Cukierman, 1994) (Goodman, 1991) (Woolley, 1984). The reason for expecting central banks to hold such preferences is due to the constraints imposed by their legal mandates. For example, the Bank of England has a dual statutory obligation to pursue financial and monetary stability; whilst the Fed is focused on maximum levels of employment and financial stability. In addition, central banks have close ties to, and are considered part of, the financial community, which results in central banks having similar preferences to the private financial sector – which also favours low inflation and long-term financial stability (Way, 2000, p. 202).

In order to understand the impact of partisanship on central bank capabilities it is important to analyse the ideological preferences of political actors and how they sit in relation to the expected central bank preferences assumed above. Way (2000) identifies two trends of interaction between governments and central banks in advanced economies. First, Left-leaning governments working with independent central banks face a more difficult task in producing their intended policy outcomes (Way, 2000, p. 203). As a result Left-leaning governments are more likely to seek additional venues in which to achieve their macro-

economic policies, for example through state-controlled agencies or government departments. Conversely, Right-leaning governments in the same institutional setting tend to hold preferences more aligned with those central banks. Therefore, Right-dominated government tends to be able to realise its partisan objectives more easily through granting greater independence to central banks (Way, 2000, pp. 202-03).

In the US the regulatory reform process was characterised by partisan disagreements between Democrats and Republicans over the power and location of new consumer protection functions stripped from the Fed and the extent of state power over business (Braithwaite, 2010) (Carpenter, 2010). Many Democrats wanted a consumer protection state agency, whilst Republicans attempted to block the Bill in the Senate over concerns about too much state power over firms (Herszenhorn & Wyatt, 2010). UK policy-making was a compromise, though likely dominated by the Centre-Right that made-up the largest party in the Commons despite being part of a two-party coalition. The UK Conservative party held the key positions within ministries relevant to financial reform, such as the Chancellor of the Exchequer and Financial Secretary. In addition, the Conservative Prime Minister also acted as First Lord of the Treasury. Though major policy decisions, such as institutional reform were subject to agreement amongst a 'Quad' of senior politicians equally dispersed across the two coalition partners.

Whilst partisan theory can help us make sense of the casual factors leading to central bank independence, the literature is unable to explain how and why a particular supervisory architecture would be more appealing than another on the basis of partisan beliefs. For example, partisan theory cannot adequately explain why a left-leaning Labour government granted central bank independence, whilst its Conservative rival declined the opportunity repeatedly whilst in government. Partisan theory fails to account for the external policy

environment in influencing strategic behaviour. In the UK the incumbent government at the time the crisis struck was the centre-left Labour Party, whereas in the USA at the outbreak of the crisis the executive branch was controlled by the Republicans, with both Congress and the Senate having Democrat majorities. The government leaders reversed in terms of partisan alignment following elections in both states after the outbreak of the financial crisis. In the UK a Conservative-led government oversaw the increase in capabilities of the central bank, whereas in the US a Democratic administration initiated the central bank reform process. In addition, partisan theory does not shed light on the behaviour of central banks and how they attempt to shape the outcome of the reform process. It assumes that the process is entirely dependent on the outcome of a partisan game. This level of analysis is not sufficient in explaining the architecture of supervision post-crisis.

Whilst partisan theory may be able to account for political actor preferences in some policy areas, in the event of an exogenous shock, such as a severe financial crisis, political preferences are often ambiguous and unclear or reactive as events unfold in real time. Instead it is worth exploring the party competition literature for a coherent testable alternative explanation. The natural strategic calculus of political parties and candidates becomes one of competition, thus they seek to maximise their utility as events unfold. This explanation derives from Anthony Downs' *An Economic Theory of Democracy* (1957). It is one of the first attempts to explain elections using economic theory. This pioneering work in 1957 started what could be called an economic theory of politics. This public choice account states that politicians are rational actors acting for self-interested ends. Downs defines politicians as acting *"solely in order to attain the income, prestige, and power, which comes from being in office. (...) Upon this reasoning rests the fundamental hypothesis of our model: parties formulate policies in order to win elections, rather than win elections in order to formulate policies"* (Downs, 1957). For political parties, an exogenous shock such as a

financial crisis is simply an opportunity. Downs assumes that political parties operate as single decision-makers, rather than explaining the detail of internal policy-making. This is a simplifying assumption, which does not impact on results (Wittman, 1973, p. 490). In addition, under this traditional model it is the incumbent party that makes its move initially, leaving the opposition to either follow its preference, or suggest an alternative idea (Wittman, 1973, p. 490).

Wittman builds on Downs' model. Downs implies political parties do not have pre-existing policy preferences, as they do not care about policies but more simplistically only care about gaining office (Dunleavy, 1991, p. 118) (Roemer, 2001, p. 7). Thus the model can be refined to account for policy preferences of political parties and for leaders and elites seeking to propose the policy preference that best maximises their party's utility (Wittman, 1973, p. 495) (Roemer, 2001, p. 7). This is a key feature of the model presented by Wittman (1973). The focus for Wittman is on maximising utility, which will mean maximising the opportunity of winning an election through adversarial politics (Wittman, 1973, p. 495). Yet that sole act of election victory is not the end of utility maximisation. Realising policy preferences is also a part of the utility maximisation process, as it leads to future rewards from the electorate (Wittman, 1973, p. 495).

Several studies suggest that institutional reform is determined by the demands of political management (Fernández-Albertos, 2015; Bernhard, 1998; Bernhard, Broz, & Clark, 2002; Hallerberg, 2002; Way, 2000). For example, Bernhard (1998) argues that the delegation of monetary policy to independent central banks can be an effective way of reconciling heterogeneous policy preferences and managing intra-party conflicts, particularly in federal systems or coalition governments. Other accounts focus on electoral incentives (Alesina, Spolaore, & Wacziarg, 1997; Lohmann, 1998; Avellaneda, 2013). These assume that

incumbent parties will tend to favour the institutional status quo so as to preserve their reputation in office; by contrast, opposition parties will seek to discredit the government by calling for reform as a symbolic break with the past. King (2005) develops such an account to explain the timing of central bank independence in the UK following the 1997 election. Hence for the Conservatives, the electoral costs of institutional reform outweighed the benefits because reform risked being perceived as an admission of failure. For Labour, however, the electoral benefits were overwhelming as it provided a powerful signal about their economic competence and commitment to low inflation (King, 2005, p. 118).

Political explanations provide a useful account of how political competition shapes institutional choice, which to date has not been tested with respect to post-crisis institutional reform of central banks, but has been applied to monetary policy outcomes. The UK Labour government designed and implemented the 'tripartite' system of regulation that was in place at the time of the crisis. As the incumbent government at the time of the crisis, it was not politically advantageous for Labour to advocate significant institutional reform, but in fact could prove highly costly with an election due in 2010. On the other hand, to argue for significant institutional reform is was an entirely plausible preference opposition parties in the UK, as they could attach blame for the crisis to Labour's institutional design. In the case of the USA, with its weaker party system and no incumbent running the Presidential election, the it would expected that Republican candidates would be forced to defend the economic policies of the Republican Administration as well as individual financial regulatory voting records. As a result political explanations are likely to be a fruitful avenue of alternative explanations for institutional reform.

Main proposition: *Politicians will undertake supervisory reform when they judge that the electoral gains from this institutional reform exceed the electoral costs. Politicians will impose their version of reform hierarchically on institutions to realise future electoral gains.*

2.4.2 Financial Industry Lobbying

The literature on the role of financial industry lobbying and regulatory 'capture' is vast (Carpenter and Moss 2014). Recent studies have shown that the financial industry has been highly influential in shaping the nature of post-crisis financial regulatory reform (Bell and Hindmoor 2015; Carpenter 2010; Culpepper and Reinke 2014; Jacobs and King 2016; Zeigler and Woolley 2016). Although central bank reform may not have an immediate impact on a firm's profit margin, macroprudential regulation and micro prudential supervision nonetheless have profound consequences for commercial banks. For example, strengthened prudential capabilities mean that bank regulators can impose tougher capital standards to strengthen the capacity of institutions to survive severe economic downturns, or impose new resolution rules designed to facilitate the resolvability of failing institutions. Moreover, such reforms often empower regulators to outlaw banks from engaging in certain types of financial activity (such as proprietary trading in the US), impose restrictions on ownership structures or cross-subsidisation between retail and investment operations (through 'ring-fencing' in the UK), or force large, complex institutions to sell off assets under the threat of being broken up entirely. Studies show that the banking industry has been highly vocal in opposing regulatory reforms which threaten to enhance the power of regulators through new prudential policy instruments (James 2016). Moreover, evidence suggests that the industry has been effective in blocking or watering down the nature of reform because elected officials rely on the industry for tax revenues, economic growth and campaign contributions (Culpepper and Reinke 2014).

The USA and UK have large and well-organised banking sectors. UK banking industry's largest lobbying body was the British Bankers' Association (BBA). It was funded by member subscriptions. At the time of the institutional reform it had 240 members and a budget of

£9.6million.[3] It had a full-time staff of over 50 people with a number of senior banking policy experts. The US banking industry was represented by the American Bankers' Association (ABA). It too is funded by member subscriptions. The ABA spent $2.36 million for the second quarter of 2010. In the April-to-June period, in addition to Congress, the ABA lobbied the White House; the departments of Agriculture, Treasury and Labour; and regulators such as the Federal Reserve, Commodity Futures Trading Commission and Securities and Exchange Commission, according to the report, filed with the Secretary of the Senate on July 19.[4] Between 2008-2010 the Securities Industry and Financial Market Association directly employed 54 lobbyists and used a further 37 from outside firms (Centre for Public Integrity, 2014). The American Bankers' Association deployed 53 lobbyists, and the Mortgage Bankers Association used 29 lobbyists (Centre for Public Integrity, 2014). Therefore levels of financial industry lobbying may be an important determinant of institutional variation in central bank reform in the US and UK.

Main proposition: Supervisory reform is the result of lobbying by the financial sector. Industry will seek to supply information on regulatory reform to achieve self-interested preferences. The greater the supply of information and access to political elites, the greater the probability of private banks' preferences influencing the institutional reform.

2.4.3 Diffusion of ideas and Epistemic Communities

Ideas are weapons that link policy means to ends suggesting options decision-makers should take (Blyth, 2001) (Chwieroth, 2010) (Finnemore & Sikkink, 1998) (Yee, 1996). In times of uncertainty and ambiguity, as the global economy experienced following the 2007/08 crisis, it is difficult for policy-makers to obtain full information about the type of supervisory arrangements that provide optimal results (Ravtez, 1999, p. 649). There is also no genuine consensus regarding ideal supervisory architecture. It is difficult to empirically determine

[3] British Bakers Association Annual Report, 2012.
[4] Yahoo.com: Bank trade group spends $2.36M lobbying in 2Q Sep 30, 2011

the extent to which a supervisory system is responsible for a crisis, whilst the crisis is on going.

Ideational accounts of supervisory and banking reform draw on the process of policy learning and diffusion (Andrews 1994; Cukierman 1994; Maxfield 1997; Strange 1996; Williamson 1993; Winters 1994 in King 2005). McNamara (2002) provides a powerful critique of standard principal-agent accounts of central bank independence, arguing that governments have chosen to delegate monetary policy through processes of organisational isomorphism. Central bank independence as an idea has been diffused across borders as countries seek to replicate models that are perceived as successful and to legitimise their own reforms. In other words, delegation occurs not because of its intrinsic functional properties, but because of its symbolic and normative value.

More recently, it has become more widely argued amongst the academic and policy-making communities that a macroprudential ideational shift occurred as a result of the 2007/08 financial crisis (Baker, 2015) (Borio, 2009) (Goodhart L. M., 2014) (Haldane, 2009) (Hanson, 2011) (Persaud, 2009) (Datz, 2013) (McPhilemy, 2013). Baker (2015) argued that post-financial crisis regulation and macroeconomic policy are characterised by differing ideational patterns (Baker, 2015, p. 344). Bell and Hindmoor (2014) argue that the ideational shift of political elites has been limited, in that they have pursued the post-crisis institutional reform agenda with a view to retaining a large and complex banking structure (Bell & Hindmoor, 2015a, p. 343). This growing body of literature highlights the importance of *"norm entrepreneurs"* in the central bank and regulatory community in promoting ideational change in financial regulation since the crisis (Baker, 2015, p. 356) (Baker 2013, 2014; Borio 2009, 2011). Specifically, they explain the rise of ideas associated with macroprudential regulation and the adoption of new countercyclical policy instruments. These have been

developed by national regulators in international fora, such as the Bank for International Settlements (BIS) and Financial Stability Board (FSB), and then diffused downwards.

These studies focus on the development of macroprudential policy and structural reform of the banking sector. They are useful in that they are able to help us make sense of cross-national similarities. However, they say little, if anything at all, regarding the role of ideas in changes to micro prudential regulation and institutional reform – a key area of cross-national differences between the US and UK reforms. For example, in the US the responsibilities for micro prudential regulation are widely dispersed amongst a byzantine structure of agencies, including the central bank. Post-crisis this is still the case, though there is slightly more concentration of authority within the central bank. By contrast the Bank of England, via its subsidiary the PRA, has micro prudential supervision authority over 1500 deposit-takers and insurers.

The concept of epistemic communities in the social sciences derives from the work of John Ruggie (1972). Ruggie suggested that epistemic communities are a group of interconnected actors built around an objective field of knowledge that is valued for its own sake. Haas (1992) builds on this work and offers four characteristics that distinguish an epistemic community. First, "*a shared set of normative and principled beliefs"* that serves as rationale for action of community members (Haas, 1992, p. 3). Second, *"shared causal beliefs"* which represent the communities account of why a problem arises (Haas, 1992, p. 3). Third, *"shared notions of validity",* which refers to *"internally defined criteria for weighing and validating knowledge in the domain of their expertise"* (Haas, 1992, p. 3). Finally, a *"common policy enterprise"* which is a set of *"common practices associated with a set of problems to which their professional competence is directed"* (Haas, 1992, p. 3).

The question remains *'how do these epistemic communities shape policy outcomes?'* Epistemic communities interpret research conducted on the basis of their expert knowledge in the context of a given problem. This interpretation takes the form of technical advice. For example *central banks interpreting causes of the crisis, and its phases, then framing solutions as advice to government. The opportunity to present technical advice to governments allows central banks to emphasise elements of their self-constructed narrative that they believe are most important, such as recommending options that maximise their utility. Central banks could argue they benefit from informational and expertise advantages, making them better equipped to manage supervisory issues* (Masciandaro, 2012, p. 118).

Antoniades (2003) accounts for epistemic communities influencing policy outcomes in two distinct ways. At a cognitive level, epistemic communities construct social reality (Antoniades, 2003, p. 29). Here the epistemic community makes sense of what is happening, for example the ambiguity that surrounds a financial crisis, and seeks to build a collective understanding of events. At a practical level, epistemic communities attempt to directly exert influence. Through their technical expertise they "*influence the conceptual framework in which every policy process is embedded"* (Antoniades, 2003, p. 30). A good example of this within the central bank-related literature is the idea of central bank independence (CBI). The Fed has long been an independent central bank, whilst the Bank of England gained independence in 1997 (Hall & Soskice, 2001, p. 461). This model of CBI was exported around the globe by the OECD and IMF, both of whom placed the idea at the centre of structural adjustment programmes during the 1980s/90s (Dyson, 2009, p. 17). It follows that those rational actors in possession of expertise during times of ambiguity frame issues and present solutions in ways that favour their preferences (Haas, 1992, p. 2). The more complex and technical a problem, the greater the power held by the epistemic community.

A weak or divided government may find itself more reliant on expert knowledge, as it does not possess the legislative majority or discipline to pass controversial legislation (Grilli, Masciandaro, & Tabellini, 1991, p. 355). If the ideas for change stem from an independent central bank rather than partisan organisation, they are more likely to be accepted across political divides – it overcomes governments' and partisan actors' credibility problems (Grilli, Masciandaro, & Tabellini, 1991, p. 365). The coalition in the UK from 2010 through to the completion of the institutional reform could be classified as a weak government that has to rely on negotiations between two political groups with equal veto power over any given legislative issue. The adversarial nature of the US system also fits this definition given the President's policy-making ability is constrained by the separation of powers doctrine. As a result actors' interests, and therefore outcomes of any action, cannot be deduced from the existing institutional environment (Blyth, 2001, p. 3). If an actor is able to articulate both the causes of an economic problem, in this case the breakdown of effective economic governance, and simultaneously present a solution, such ideas act as a challenge to existing institutional arrangements (Blyth, 2001, p. 3).

It is important to note, not all ideas are successful in being translated into policy choices. The ideas that are successful are those that have found an institutional home, where a team of like-minded individuals transform ideas into bureaucratic purpose (Adler 1987, Hall 1997, Berman 1998, McNamara 1998, Sikkink 1991). The level of promotion is an important factor in this success – through mobilisation of academic work, public opinion and media support. Second, as previously mentioned, decision-makers are unclear about their preferences in times of ambiguity. During crises ideas that are clear and articulated in terms of means and ends are more likely to be taken seriously (Tsebelis, 1990, p. 18). The epistemic

communities literature maybe useful in terms of identifying where and how ideas develop and also in terms of identifying true preferences of central banks.

If successful, epistemic communities are able to generate greater cooperation and influence state action as a result of operating closely with political elites. If policy networks manage to acquire influence within the bureaucracy, they can influence policy decisions within the government (Haas 1989). Through this capacity, bureaux may become policy entrepreneurs in which they try to gain the attention of relevant decision-makers in order to advance their aims (Baumgartner and Jones 1993; Sabatier and Jenkins-Smith 1999).

In his study of central banks in the US and UK, Kapstein argued central banks did not constitute an epistemic community but "*were a group of bureaucrats...attempting to serve several conflicting public and private sector interests in an effort to maintain if not enhance their positional power"* (Kapstein, 1992, pp. 266-67). Writing over twenty years ago, Kapstein suggests that whilst central banks were not yet an epistemic community, *"they are becoming increasingly like one"* (Kapstein, 1992, p. 267). This section explores the features of epistemic communities paying attention to the ways in which this group could influence policy decisions about central banking remits. More recently, Baker (2015), points to the importance of the central banking epistemic community in the development of the idea of macroprudential regulation (Baker, 2015, p. 356).

King (2005) provides such an account to explain why central banks are granted increased powers to determine interest rates. Partisan approaches, based on desire to control inflation, cannot explain why a Labour government granted central bank independence to the BoE, but Conservatives opposed it. The explanation is that it provided electoral incentives for opposition as it enabled them to achieve a political goal of demonstrating

economic competence; for the Conservatives there was no incentive to break with continuity, as this would be an admission of failure. An epistemic community of central banks could argue they benefit from informational and expertise advantages, making them better equipped to manage supervisory issues (Masciandaro, 2012, p. 118). A weak or divided government may find itself more reliant on expert knowledge, as it does not possess the legislative majority or discipline to pass controversial legislation (Grilli, Masciandaro, & Tabellini, 1991, p. 355). Post-2010, the UK government could be described as weak and divided, given it was a coalition of Conservatives and Liberal Democrats. The political landscape of the US, which requires some form of coalition between the executive and legislature, could also fit this definition. If the ideas for change stem from an independent central bank rather than a partisan organisation, they are more likely to be accepted across political divides – it overcomes governments' credibility problem (Grilli, Masciandaro, & Tabellini, 1991, p. 365).

A potential problem is that role of epistemic communities can be left unproven and the significance of ideas can be ambiguous. It can leave unanswered which causal factor is exogenous to the model: preferences or ideas? It dismisses distinctions between rational choice and constructivist accounts of ideas, but these are fundamentally incompatible and tend to default to the former (King, 2005, p. 18). The heavy lifting of King's (2005) account is performed by incentives or opportunity structures. Hence it hints at the importance of ideas being used strategically as a resource in political and bureaucratic games. King acknowledges that epistemic communities provides necessary but insufficient conditions for reform. Essentially, new ideas will only be adopted when they serve political ends (King 2005, p118). Here the importance of ideas is less to do with the role of epistemic communities in shifting preferences of political actors, and more an exercise in strategic constructivism (Schmidt and Radaelli 2004). King's account is essentially rooted in rational

choice assumptions, but one that is incomplete. It specifies a broad condition under which ideas are used as a resource (political salience or incentives), but does not specify the process through which these incentive structures shape actor behaviour.

The central banks in both the US and UK, along with other national regulatory agencies, were assiduous attendees at international fora on a regional and international basis. Most prominently both engage heavily with the Bank for International Settlements (BIS), the Financial Stability Board, World Economic Forum, OECD and academic research. The BIS is an international body owned by central banks and facilitates cooperation and collaboration amongst international central banks on a host of policy issues. Policymakers are exposed to the same economic research spread through and emanating from this transnational network centring on these central bank-led international institutions. On this basis, the power of ideas from such a group could be a potential explanation for the institutional reforms observed. If the ideational alternative explanation holds true, I would expect the process to reveal the following:

Main proposition: *Politicians are influenced into granting supervisory reform in response to ideas promoted by an epistemic community of regulatory experts.*

2.5 Summary of propositions

This thesis aims to explain the decision-making process that led to post-crisis macro and micro prudential institutional reforms. It aims to aid how we think about central banks in a consistent way across countries; how they affect policy development; and how they impact other important characteristics of a political system, such as other institutional arrangements, via their influence. The goal is to identify the dimensions along which decision-making in different polities differs, and to study the effects of such differences on

the post-crisis development of central bank capabilities in the USA and UK. In doing so it builds on much of the post-crisis research in political science pertaining to the diffusion of macroprudential policy.

This chapter has reviewed the existing literature on central bank institutional reform. One of the major themes of central bank and supervisory reform is the number of actors that can potentially be involved. These include politicians, civil servants, political advisors, central banks, commercial banks and agency regulators. Many of these actors will have their own preferences and will attempt to influence governments and other actors to enact their own preferences. In essence, this major theme is about institutional change and in order for change to be realised a number of actors most agree to it. The literature review also highlights that decisions are rarely made in isolation and thus to study them as such would be an enormous over simplification. Instead, the framework deployed in this thesis considers decisions regarding the reform of advanced economy central banks as embedded within institutional constraints.

This chapter has examined the theoretical foundations of this research, linking the form of behaviour of actors with the outcome of an increase in central bank capabilities post-financial crisis.

To summarise, the propositions that this research tests are outlined below:

Main propositions:

P_1. *Institutional constraints:* *Political systems with fewer checks and balances will find it easier to enact institutional reform, while countries with federal systems or higher fractionalisation will make institutional reforms that are closer to the status quo (layering).*

P_2. *Bureaucratic politics:* *If bureaucratic power is concentrated, central banks are likely to wield greater influence over the institutional reforms, moulding them in line with their own preferences. Whereas, if bureaucratic power is diffused across multiple agencies, central banks will be less influential in shaping institutional reforms in line with their own preferences.*

Alternative propositions:

Political explanations: *Politicians will undertake supervisory reform when they judge that the electoral gains from this institutional reform exceed the electoral costs.*

Epistemic community: *Politicians are influenced into granting supervisory reform in response to ideas promoted by an epistemic community of regulatory experts.*

Financial sector lobbying: *Supervisory reform is the result of lobbying by the financial sector. Industry will seek to supply information on regulatory reform to achieve self-interested preferences. The greater the supply of information and access to political elites, the greater the probability of private banks' preferences influencing the institutional reform.*

2.5.1 Summary of Predictions

The table below summaries the explanatory factors in each case study and the proxies used to measure them.

Table 2: Summary of explanatory variables

Theory	Proxy	USA	UK
Political Institutional	Political system	Federal and Presidential; fractional party system	Westminster system' strong party system
Economic institutional	Central bank statutory mandate	Monetary, conduct; bank supervision; consumer protection.	Monetary and financial stability
Bureaucratic politics	Bureaucratic power: Number of Banking regulatory agencies; agency preferences; influence.	Diffuse	Concentrated
Epistemic community and ideas	Participation in international fora; influence of ideas; and Individual policy entrepreneurs.	High	High
Political	Electoral and partisan incentives	Centre-left	Centrist and right coalition
Financial Lobbying	Budget; membership numbers.	High	High

The review of explanatory variables suggest that a number of the proposed explanatory variables could explain the institutional reform of banking regulation seen in both the US and UK. On the basis of the main propositions, I would expect the following outcomes.

Table 3: Theory based predicted outcomes of case studies

		Bureaucratic Structures	
		Concentrated bureaucratic power	**Diffuse bureaucratic power**
Institutional Constraints	**High political veto possibilities**	*Absorption*	*Layering* (USA)
	Low political veto possibilities	*Subversion* (UK)	*Displacement*

Chapter 3. Methodology

3.1 Introduction

This research examines the increase in supervisory capabilities of advanced economy central banks post-financial crisis. The previous chapter generated explanatory propositions to be tested on the basis of the existing literature within political economy. The time period under investigation ranges from the outbreak of the financial crisis in late 2007, through to the formal changes to the supervisory capabilities of both the Bank of England (2012) and Federal Reserve Bank (2010). This time period allows for an in-depth understanding of the interactions amongst the key actors involved in the decision-making process. This section explains the methodological framework and how tests for the causal mechanisms identified in the literature review are conducted. The dependent variable is the post-crisis regulatory architecture.

The methodological framework employed throughout this research is derived from the existing literature on central bank reform and bureaucratic behaviour. The within case analysis controls for elections and party, but provides several observations of institutional change. This thesis uses process tracing to reconstruct actors' preferences, motivations and actions. The research design outlines how the casual mechanisms associated with these theoretical works have been tested. The dependent variable is measured through the supervisory architecture outlined in the Financial Services Act 2012 and the Dodd-Frank Wall Street Reform Act 2010. This legislation ended a rethink of the role of central banks as part of re-shaping banking supervision. These reforms are examined alongside actors interactions from the outbreak of the crisis in both domestic polities until the final reforms were ratified. Triangulation through elite interviews, process tracing and a case study methodology help to limit any shortcomings in the detail contained within each case study and the conclusions drawn. The research, in the round, aims to present a generalizable

account of the mechanisms that link the dependent variable and independent variables in order to generate greater knowledge about the way in which advanced economy central banks respond to significant reform of their capabilities.

3.2 Research question

This research is designed to broadly examine central bank behaviour in response to proposals to alterations to their responsibilities. It is specifically concerned with the strategies central banks deploy in order to maximise utility. This is achieved empirically via answering the following research questions:

Main research question: *How and why has post-financial crisis central bank institutional design taken the particular form it has in advanced Western economies?*

In answering this question a number of sub-questions are also addressed by this research. These are outlined below:

- What were the institutional reform preferences of the actors involved in the institutional reform process?
- How did central banks try to shape the outcome of the institutional reform process?
- Which actors had the most influence over institutional reform process?
- How did advanced economy central banks operate prior to the financial crisis?

The reform of advanced economy central banks has been one of the most significant institutional developments since the 2007/08 financial crisis. In the US and UK new regulatory and supervisory powers have been delegated to central banks in an effort to increase the stability of the financial system. Yet surprisingly little is known about the politics of central bank reform. The research assesses central banks' intangible assets such as its

ability to influence strategic goals and use of expertise. Many studies of the central banks have overlooked this in favour of monetary policy analysis.

3.3 Research Design

The previous chapter developed a series of propositions that are tested in the empirical research of this thesis. This section explains how this is done. The dependent variable is the post-crisis regulatory architecture. The independent variable is competing actor preferences. The potential causal forces making the dependent variable intelligible can be grouped into categories: 1) formal authority, which includes influence, organisational membership and 2) technical expertise and knowledge. The remainder of this chapter outlines how these causal forces have been operationalized and tested.

3.3.1 Process tracing

The primary methodological approach used throughout this thesis is process tracing. Process tracing is *"synonymous with an understanding of theories as based on causal mechanisms"* (Checkel, 2005, p. 3). Hedstroem & Swedberg (1998) define mechanisms as *"a set of hypothesise that could be the explanation for some social phenomenon, the explanation being in terms of the interaction between individuals…"* (Hedstroem & Swedberg, 1998, p. 25). The use of mechanisms provides a more detailed explanation of the processes taking place in social phenomena (Johnson, 2002, pp. 230-31). This focus on process tracing and mechanisms is appropriate given the literature outlined in the previous chapter. In particular, the bureau-shaping literature tends to lack an assessment of casual mechanisms that allow bureaucrats to shape their bureaux. Thus this approach adds significant value to this theory.

There are major benefits to adopting a process tracing approach to this research. First, process tracing forces the researcher to consider counterfactual endings (Checkel, 2005, p. 5). It directs the researcher to trace the process in a highly detailed and theoretically informed manner (King, Keohane, & Verba, 1994, p. 227) (Checkel, 2005, p. 6). Counterfactual analysis constitutes an essential element of the methodological approach. Counterfactual analysis is an imaginary construct that emphasises the importance of understanding what could have happened if one or more of the casual mechanisms were removed from the chain of events. This involved asking interviewees how they think the dependent variable would have looked in the absence of coherent preferences of the actors involved in the process. This should, ultimately, lead to a stronger understanding of the links between dependent and independent variables and greater confidence in the findings of this research. The data that informs a process tracing approach is overwhelmingly qualitative in nature. Furthermore, process tracing guards against the possibility of endogeneity, when the explanatory variable may well be a consequence, as opposed to a cause of, the dependent variable (King, Keohane, & Verba, 1994, p. 185).

That said, process tracing is not a perfect methodological technique, and it is worth spending some time outlining its potential flaws. First, process tracing is considered weak in terms of theory building (Checkel, 2005, p. 17). The end product is "*at best partial, middle-rage theory*" (George & Bennett, 2005, p. 216). This can be mitigated via a clear and detailed research design (Checkel, 2005, p. 17). Second, the methodology is entirely reliant on proxies (Checkel, 2005, p. 18). For example, in this research focuses on the mechanisms of expertise and influence, yet I have not seen any actor directly influence another nor have I witnessed real time changes in strategy or preferences. As a result I am reliant on conceptual variables being verified by proxies. As explained latter in this chapter, methodological triangulation is used throughout this research in order to prevent over

stating the casual mechanisms at play. Third, given the volume of data that the researcher must process, there is a risk of losing sight of the aim of the research (Checkel, 2005, pp. 18-19). This issue also has implications in terms of the lifetime of the project.

As discussed within the strengths and weaknesses of process tracing, the technique requires the analysis of large volumes of information from a number of sources (George & Bennett, 2005, p. 6) (Tansey, 2007, p. 2). Indeed this research utilises contemporary historical accounts of the crisis written by key actors and journalists, media reports, legislative papers and Bills, central bank minutes and transcripts, as well as a 42 of elite interviews.

In order to maximise the strengths and minimise the weaknesses of process tracing, this research utilises the methodology as set out below. Process tracing was structured around the four crisis phases within each case study: the Mortgage market dysfunction; banking crisis; sovereign debt crisis; and economic recovery; and key events such as changes in political leadership, major bank collapses, financial crisis inquiries, and formal legislative announcements. The table below highlights observations related to crisis phases on which process tracing has been structured:

Table 4: Timeline of key phases and key event in the crisis.

Phase	Dates	Event/ expected observations
Mortgage market dysfunction	Summer 2007 in USA/Autumn 2007 in UK	Central banks intervene to manage the crisis using traditional tools. Northern Rock collapse Key actors believe the crisis will be short-term and no exceptional measures are required. No recognition of supervisory failure. No discussion of alternative supervisory arrangements.
Banking crisis	Sep 15 2008 Sep 16 2008 Aug 2008	Lehmann Bros collapses in USA. AIG bailout RBS collapse in UK International central bank cooperation begins and shared beliefs regarding causes of the crisis and what responses should look like discussed. Supervisory failure becomes apparent. Acceptance amongst decision-makers that central banks capabilities need to be increased. Triggered very significant processes, regulatory initiatives that go further than crisis management and that aim to reinforce financial market structures.
Change in principal	November 2008 January 2009 5 May 2010	US Presidential election Change in executive and legislature composition UK General Election Change of Govt in UK. Reveals constraints on central bank power
Economic recovery	 June 2009 June 16 2010	Formal proposal announcements Dodd-Frank Wall Street Reform Act proposed by US President. Abolition of FSA officially confirmed by HM Treasury.

I have conducted 42 interviews with key actors across two case studies. Primary and secondary sources, including speeches, press releases, consultation responses, government

reports, think tank research papers and academic publications, have been evaluated to obtain information about the processes of central bank institutional reform. Triangulation is important for producing reliable data. As such the sources mentioned above have undergone process tracing to cross-reference the validity and reliability of interview findings. Any data within the gained through interviews that has not been backed-up by other interviews or published accounts of events has not formed part of this final research. The purpose of collecting this qualitative data was to frame a narrative for each case study to which theory is then applied.

3.3.2 Elite Interviews

Elite interviewing is highly relevant to a process tracing approach (Tansey, 2007, p. 4) (King, Keohane, & Verba, 1994, p. 227). This research requires analysis of political developments at the highest level of government and central banks, thus elite actors are critical sources of information (Tansey, 2007, pp. 4-5). Forty-two semi-structured interviews were conducted for this research. These were conducted with senior civil servants and officials, politicians, political advisers, central bank officials, and commercial banks employees. All of those interviewed were involved directly in the decision-making process. This figure includes a small number of financial journalists who specialise in reporting on the central banks concerned were interviewed. These journalists were not directly involved in the negotiations, however they have intimate knowledge of the process due their privileged access to those actors directly involved. All interviews were conducted between 2013–2017.

Interview contributions were achieved in large part due to my professional background in financial services and government relations, which allowed me to foster significant contacts within policy-making and financial communities, particularly in the UK. The snowball effect

from the UK case study allowed me to secure a number of interviews in the USA. The actor groups that participated in this research are outlined in the table below. These are shown as broad groups in order to protect the anonymity of participants.

Table 5: List of anonymised interviewee sources and rationale for inclusion.

Actor Group	Participants	Rationale for inclusion
Government	Treasury ministers/sectaries Commerce ministers Government Executives Special advisors to key ministers Civil servants	Key decision-makers and close to the reform processes.
Parliamentary/external committee members	Treasury Committee members Reform-related commissions Financial Services Bill Committee members (UK) Financial Services Committee members (US) Senate Banking Committee members (US)	Political officials with oversight of banking regulation, responsible for producing key reports throughout the reform processes and open to influence either from central banks or private banks. Also groups with a degree of decision-making power.
Financial community	Central banks (Fed, BoE, PRA, FCA, FPC) Agencies (SEC, FSOC, CFPB, OIA) Banking trade associations (BBA, ABA) Commercial banks	Key actors who potentially influenced the reform processes in each case study.
International Organisations	Basel committees on banking supervision International Monetary Fund OECD G20 Financial Stability Board	Key organisations through which central banks may form epistemic communities. All were involved in initial attempts to tackle the banking crisis through regulatory measures.
Research community	Business school academics Political science school academics Think tanks	Informal discussions to aid process tracing with researchers working on similar issues.
Media	Financial and business journalists Political correspondents Economic correspondents	Informal interviews for process tracing. Journalists engage with the financial community and policy-makers.

Conducting these elite interviews helped provide information that was not available in the public domain, and their insights were used to help corroborate the findings of the research. It is worth noting that with particular reference to the Bank of England case study, I was able

to gain privileged access to senior officials across the audience map that are not readily available to many researchers. The snowball effect was extremely important in securing the high volume of interviewees for the UK case study. It is important to note that the interviews were requested and conducted under terms of individual, though not institutional, anonymity due to the sensitive nature of central bank public policy work.

It is important to note central bankers are on occasion reluctant to participate in studies such as this. In order to by-pass this potential obstacle I predominantly targeted senior individuals within each institution that played a role in the institutional reform process, but had since retired or left the institution. This approach means that each case study is still able to make a meaningful contribution to the field through interviews with actors intimately involved in discussions regarding central bank reform post-financial crisis. Published accounts of the role of central banks in the reform processes have also been utilised significantly. This includes central bank committee minutes.

Conducting the interviews involved extended travel to the UK and the USA where I was able to enrol as a visiting scholar at University College London, King's College London and Columbia University in the City of New York. Affiliation to these top schools in the jurisdiction of each central bank lent significant credibility to this project and provided better access to interviewees. Whereby individual central bankers where prohibited from speaking with me, more often than not they provided contacts details of relevant former central bank employees that were free to answer questions on the decision-making process.

3.3.3 Case selection

This research uses a case study approach. A case study is an *"intensive study of a single unit for the purpose of understanding a larger class of (similar) units"* (Gerring, 2004, p. 342).

This is a multi-case study thesis with a holistic focus on the increase in supervisory capabilities of advanced western economy central banks. That said, it also follows an embedded case study approach (Yin, 2003), given the multiple units of observation such as temporal factors and preferences of different actors in each case study.

The primary rationale for case selection is based upon cases that are alike in as many ways as possible (a variety of potential sources of institutional variation, such as the size of the financial sector; the impact of the crisis; and changes of government), except for variation in the dependent variable. This research focuses on the US Federal Reserve Bank and the UK's Bank of England as case studies. The UK and US are valuable case studies for developing and testing explanations of post-crisis institutional change in several respects. First, the US and UK have structural similarities. They both operate Anglo-Saxon varieties of capitalism. They both fit the pattern of countries that have large and volatile financial sectors. As such they traditionally favoured 'light touch', 'principles-based' financial regulation and were important drivers of financial deregulation in the decade preceding the financial crisis (Howarth and Quaglia 2016). Second, these structural similarities meant that both economies were severely hit by the impact of the global financial crisis. As a result, several large financial institutions required direct recapitalisation by the state, while the sector as a whole was supported through the provision of 'quantitative easing' by the central banks (Bell and Hindmoor 2015). Third, both countries underwent a change of government at the height of the crisis. In the US, the Democrats gained majorities in both Houses of Congress and won the Presidency in November 2008; in the UK, the Labour government was defeated and a new Conservative-led Coalition Government formed in May 2010. Finally, these two central banks were headed by long-standing leaders: Ben Bernanke as Chairman of the Federal Reserve; and Mervyn King as Governor of the Bank of England. They were

appointed prior to the financial crisis and remained in office throughout the period of our analysis.

These commonalities allow for control of a range of economic, political and agency-related factors. This in turn lends itself to generalising the findings and testing them against other instances of central bank reform in advanced economies, such as the Swiss National Bank or European Central Bank. As the literature review highlights, there is no consensus regarding ideal supervisory capabilities and central banks, thus explanations that rely on shared international pressures are, therefore, of limited use; instead researchers have to examine how these are mediated by domestic agents and institutions. This approach also provides an opportunity to construct a more encompassing theory of central bank reform. Finally, as set out in the literature review and the empirical chapters, post-crisis institutional change in the UK and US does not fit existing explanations based on partisan theory, traditional principal-agent analysis, or policy learning. It therefore offers a unique opportunity to demonstrate the methodological value of employing actor-centred institutionalism (ACI) to shed new light on central bank reform. To the best if my knowledge, this is the first attempt to apply simple game theoretic concepts in order to model bureaucratic dynamics.

There is significant variance in the dependent variable across the case studies. Both central banks have been reformed and their supervisory capabilities enhanced, albeit in different ways. For example in the US a new FSOC has been created and is chaired by the Treasury Secretary – a national politician. In contrast the UK has seen the creation of the FPC within the Bank of England, which is chaired by the Bank's governor. Both new institutions, the FSOC and FPC, are charged with exercising a macroprudential regulatory role. The rationale for selecting these cases is outlined below. One criticism may well be that the researcher is selecting on the dependent variable. Whilst this may appear the case at first glance, further

investigation reveals significant variation in terms of the dependant variable, thus more can be learnt about the causal mechanisms in my explanatory sketches. This variance is highlighted in table 6. That said, selecting on the dependent variable is not necessarily unhelpful, as it allows for *"singling out different paths to certain outcomes"* (della Porta, 2008, p. 216). It is also the case that prior knowledge of cases allows for much stronger research designs to be developed (George & Bennett, 2005, p. 24). The US model has become more centralised when compared to the highly fragmented pre-crisis system. Though, overall, the US system of banking regulation remains relatively fragmented. The UK system has become significantly more centralised under the remit of the central bank. Despite facing the same threats each of these central banks has had its capacities increased in different ways and at different times from 2009-20112. For example, the Fed houses a consumer protection agency, but has no authority to instruct it; whereas the Bank of England has a veto over the FCA, which is housed externally and not technically part of the central bank.

Table 6: Comparison of variance in post-crisis central bank supervisory capabilities.

Theory	Proxy	USA	UK
Political Institutional	Political system	Federal and Presidential; fractional party system	Westminster system' strong party system
Economic institutional	Central bank statutory mandate	Monetary, conduct; bank supervision; consumer protection.	Monetary and financial stability
Bureaucratic politics	Bureaucratic power: Number of Banking regulatory agencies; agency preferences; influence.	Diffuse	Concentrated
Epistemic community and ideas	Participation in international fora; influence of ideas; and Individual policy entrepreneurs.	High	High
Political	Electoral and partisan incentives	Centre-left	Centrist and right coalition
Financial Lobbying	Budget; membership numbers.	High	High

Furthermore, these central banks have been chosen because their jurisdictions are consistently ranked at the top of the Global Financial Centres Index. At the time of writing

London and New York occupy the top two positions in the ranking (Yeandle, 2015). The methodology deployed by the ranking considers a number of factors: skilled personnel; regulatory pressure; and level of business education. The results are compiled through interviews with members of the financial community in order to assess the competiveness of a financial centre. The results consistently highlight London and New York as the *"only two genuinely global financial centres"* (Z/yen, 2005, p. 4). These regions contain the highest concentration of systemically important banks that one would not find in, for example, Canada, New Zealand or Australia. As a result one would expect these jurisdictions to have significant levels of the measurable factors such as expertise, knowledge and influence that form integral elements of the explanatory mechanisms that concern this research. The markets served by these central banks were the most affected by the financial crisis (Yeandle, 2015). Moreover, the US in particular remains the largest market in the world (Carter, 2014). As a result one would expect the greatest mobilisation of influence to occur around these central banks, as opposed to those central banks governing small financial markets. In the UK context, London was the first major financial centre to unify all financial supervision under a single agency supervisor in 1997. Many other financial markets followed London's move (McPhilemy, 2013, p. 749). The UK has now reversed this decision, centralising authority with the central bank.

Post-crisis expansion of central bank supervisory capabilities is less likely to be a complex, and therefore empirically interesting, issue for other regions. Many other central banks are watching these institutions for signals of how to react in the future. The choice of these case studies is, therefore, critical in advancing our empirical and theoretical understanding of the politics of central bank reform.

3.3.4 Analysing influence

Analysing influencing ability of key actors is critical to the understanding of how and why central banks' supervisory capabilities have expanded. Influence is defined as: *the ability to determine the practice of others on the basis of the preference of the holder of influence.* The assessment of influence has proven an *"exceedingly difficult question"* in political science (Loomis & Cigler, 1995, p. 25). Baumgartner and Leech go further classifying influence as an area of "*confusion*" (Baumgartner & Leech, 1998, p. 13).

This research acknowledges measuring influence is difficult, but not impossible. As a result, this thesis follows a method adapted from Dür (2008). Dür explains there are three ways to measure influence: process-tracing, assessing 'attributed influence', and gauging the degree of preference attainment. While each method has its flaws Dür accounts for this through methodological triangulation to overcome difficulties in measuring influence (Dür, 2008, p. 4). All three measurements are used in this research.

First, the data collected through interviews has been analysed using process tracing. Dür (2008) posits process tracing has a number of advantages for assessing influence. For example, it can result in clear identification of factors influencing decision-making (Dür, 2008, p. 563). When used to analyse semi-structured interviews, the researcher is provided with a greater insight through asking more challenging questions of subjects (Dür, 2008, p. 563). This qualitative approach allows researchers to grasp and accommodate *'the micro-foundations of individual behaviour that connect hypothesised causes and outcomes to reduce the difficulties associated with unobserved contextual variables'* (Falleti, p. 1).

However, there are limitations with this method of measuring influence. First, it can be difficult to elicit all details required to explain the process, which could lead the researcher

to underestimate influence where there appears no evidence in an element of the casual chain (Loomis B. A., 1983, p. 186). Second, being heavily reliant on interview content is a weakness as interviewees can understate or overstate the degree of influence exerted in a given context. For example actors may choose to overstate influence, whereas decision-makers may be eager to appear less amenable to influence – thereby underreporting (Loomis & Cigler, 1995, p. 25). In addition, when recalling events that took place in the past, accounts may be less reliable (Dür, 2008, p. 563). It is also important that the researcher is aware preferences can be to keep something off the agenda or that historical lobbying efforts by groups can be anticipated by decision-makers thereby altering reform proposals implicitly (Dür, 2008, p. 564).

Interviewees were asked to provide self-assessment and peer assessment of the influence of actors in the reform process. Though basic in approach, it was easily implemented during face-to-face interviews. Attributed influence as a technique in research methodology takes account of *"influencing reputation"* of an actor (Dür, 2008, p. 565). There are, however, criticisms associated with this technique. Self-assessment of influence is subject to either exaggeration or underreporting (Dür, 2008, p. 565). Dür (2008) points out that actors may wish to protect their influence by underreporting and preventing counter groups from entering the policy-making arena. Alternatively, trade associations have a vested interest in being viewed as providing value for money to members. Thus they may overestimate their influence. Respondents answered by selecting a number on the following five-point scale:

1 = Large influence

2 = Some influence

3 = Not much influence

4 = No influence

5 = Do not know

The third method is measuring the degree of preference attainment of key actors, in which the outcomes of political processes are compared to the ideal points of actors (Dür, 2008, p. 11). The process involves taking two different measures: the initial position of actors and the ideal position of the government; and the ideal position of actors and the institutional outcome. Assessing influence would therefore require a comparison between actors' preferences and the final outcome.

3.3.5 Measuring expertise

Participants completed a survey question during the interviews to measure expertise. This asked participants to rank their organisations and others in terms of perceived expertise in the field of financial supervision. Respondents answered by selecting a number on the following three-point scale:

1 = High level

2 = Medium level

3 = Low level

4 = Zero level

5 = Do not know

This was supplemented with semi-structured interview questions, such as: *"How often does your organisation seek financial regulatory-related information from these institutions as part of the daily work routine?"* and *"How often does your organisation seek expert advice on regulatory issues from these institutions?"*

3.4 Conclusion

This thesis sets out to answer a research questions in contemporary public policy and add to the sparse literature on the politics of central bank reform. It outlines a research

methodology that combines process tracing, elite interviews and a case study approach. It identifies triangulation as critical, as such both secondary and primary sources are used alongside substantial interview data to better ensure the validity and reliability of the conclusions drawn through this project. The chapter summarised the dependent variable and how it is measured. It also outlined how the casual mechanisms have been tested.

The reform of advanced western economy central banks has been one of the most significant institutional developments since the financial crisis. In the UK and US new regulatory and supervisory capabilities have been delegated to central banks in an effort to increase the stability of the financial system. Yet surprisingly little is known about the politics of central bank reform. This research contributes to this literature whilst also filling a void in other areas of political economy – such as the role and influence of independent central banks within the Anglo-Saxon variety of capitalism.

Chapter 4. Historical development of central banks' capabilities and banking regulation

4.1 Introduction

The purpose of this background chapter is not to provide a blow-by-blow account of each central bank's history. Rather, in order to prevent misunderstandings of the explorations that follow within this thesis, it is important to understand how each central bank evolved over time with regard to its relationship with supervision of the banking system. To understand what is happening today and how central banks came to wield such power, we must understand what has happened in the past. Within this context, this section examines the history of the Bank of England and US Federal Reserve System.

The role of a central bank is traditionally characterised by the work of Walter Bagehot. The Bank of England found in the 1860s and 1870s that the correct behaviour of a lender-of-last-resort is to furnish the liquidity to the market by discounting freely when presented with good collateral, at a penalty rate of interest to incentivise borrowers to repay loans and maintain adequate liquidity (Cooley, Schoenholtz, Smith, Sylla, & Wachtel, 2010, p. 52) (Gorton & Ordonez, 2014, p. 1). The Bank of England and US Federal Reserve System argue they followed this advice in relation to the 2007/08 crisis (Gorton & Ordonez, 2014, pp. 1-2). As the crisis worsened, however, the central banks engaged in more conventional activities. The result has seen significant changes to the capabilities of central banks.

It is worth, at this juncture, explaining the broad trends in central banking that characterise the changes in the approaches of central banks. This is, of course, alluded to in more detail in the literature review section of this thesis, where central banks interaction with the living-banking sector is discussed in more detail. It is useful to begin with the paradigm that dominated from 1930 through until the 1990s – that of government control. The Great

Depression and the end of the gold standard represented a huge loss in terms of capabilities for central banks. Goodhart argues there was not a great deal of theory that guided this government takeover of monetary policy, but rather it was a simple pragmatic response to what was then the worst financial crisis in history (Goodhart C. A., 2010, p. 2). The finance minister generally acted on the information provided by his own officials, rather than those of the external central bank. Instead, central banks began to build expertise in analysing market behaviour. Goodhart (2010) and Moran (1991) both emphasis this in the case of the BoE and HM Treasury. Throughout this period HM Treasury sought to heavily censor the BoE Quarterly Bulletin and vetoed the Bank's attempts to publish its own economic forecasts. In return, the BoE made clear its distain when HM Treasury attempted to second officials to private sector City institutions in order to gain market expertise. The Bank, at this time, viewed its role as the ambassador of the City – a broker between financial institutions and government.

A prevailing concern following the Great Depression was that competition in the banking sector had been disastrous as it encouraged banks to pursue more risky strategies as they competed for profit, thus many of the reforms passed in terms of banking regulation were designed to stifle competition (Goodhart C. A., 2010, p. 3). Conditions were controlled by governments so as to constrain credit expansion of the private sector and mortgage markets, as this level of control is generally a pre-requisite of a low-risk economy. Thus there was a significantly lower level of bank failure throughout this period (Goodhart C. A., 2010, p. 3). Essentially, during this period central banks provided: advice on policy decisions; administration of controls decided by government; and management of markets.

As globalisation and rapid leaps forward in technology and innovation set in, this post-depression cocktail of state control and administrative central banking drew to a close. This

in turn precipitated a number of banking-related crises in the 1960s and 70s. The collapse of the Bretton Woods system ushered in a period of worldwide growth as markets became less constrained. High inflation followed during the 1970s, in what Goodhart describes as a period of confused policy-making (Goodhart C. A., 2010, p. 5) (Bowman, et al., Central Banks-led Capitalism, 2013, p. 461). The post-crisis central bank orthodoxy collapsed with the "Volcker shock", which introduced a belief that monetary policy implemented by central banks was the best method of achieving price stability (Bowman, et al., Central Banks-led Capitalism, 2013, p. 461). This moved central banks towards becoming technocratic institutions renowned for controlling inflation with expertise in market regulation, economic analysis and financial stability (Bowman, et al., Central Banks-led Capitalism, 2013, p. 455). Throughout the 1980s there was a trend towards making central banks independent, this autonomy created more of a persona of professional prestige around these institutions, which increasingly focused on inflation targeting rather than financial stability (Masciandaro, 2012).

4.2 The Bank of England

The BoE was founded in 1694 as the Government's banker and debt-manager. It is the second-oldest central bank in the world and, until the Second World War, was the most important in Europe. It is considered amongst the most influential central banks in the world. Over time its role has developed and evolved, centring on the management of the UK's currency and its position at the centre of the UK's financial system. The Bank's relationship with banking regulation has fluctuated over its history and this section examines the previous changes in the Bank's capabilities regarding banking regulation. This important narrative highlights that the Bank's capabilities have been closely aligned to the UK's economic, financial and political history. The Bank was privately owned until its nationalisation in 1946. The nationalisation conducted by the left-leaning Labour

government, allowed the Bank to issue formal directions to private banks. However, it declined to use this power, instead continuing to issue *"requests"*, as it had done pre-nationalisation (Geddes, 1987, p. 98). Crucially the nationalisation Act also mandated HM Treasury to direct the Bank on issues of public interest. This would suggest that prior to nationalisation Whitehall viewed the Bank as acting independently (Quaglia, 2008b, p. 18). Its influence has become greater over the years, and yet it remains one of the most secretive institutions in British political economy.

4.2.1 The Bank of England and financial regulation (1918-1997)

After the First World War, London's position as the preeminent centre of finance had been hurt. This position was further weakened by the onset of World War II (Geddes, 1987, p. 132). As a result the BoE's prestige declined. The Bank sought to actively reverse this decline over a number of years. Geddes highlights that whilst domestic banking remained under the control of the BoE, the banking international economy which had little impact on the UK was allowed to grow with no regulatory intrusion from Threadneedle Street (Geddes, 1987, p. 133). It should be emphasised that these were offshore banking activities that dealt in the "Eurodollar" market. This was in contrast to what Private banks viewed as overbearing regulation in New York for the same market. The result saw the number of foreign banks operating in London treble between 1970 and 1980, including more American banks in London than in New York (Moran, 1991, p. 55). Prior to the late 1970s London banking regulation stood in stark contrast against other financial centres. It worked through informal agreements between private banks and the BoE, through flexible arrangements and without legal sanction (Moran, 1991, p. 56).

Also during this period there was a significant increase in political and consumer pressure on the banking sector to reform its anti-competitive practices that saw all major banks offer

consumers very similar deals and the same interest rates (Geddes, 1987, p. 99). In May 1967 a government agency, the National Board for Prices and Incomes, issued a report that called for an end to this *"cartel arrangement...against the public interest"* (Geddes, 1987, p. 99). This report was supported by the Monopolies Commission. The BoE seized this opportunity to produce its own report, entitled 'Competition and Credit Control' which eventually became a policy the Bank enacted. Under the policy the Bank ceased to issue 'requests' on the level of lending banks undertook and banks were actively encouraged to compete against each other for more business. The implementation of Competition and Credit Control is viewed by Geddes as a political victory for the BoE, as it had for many of the post war years been forced to act on the will of politicians in manipulating the market via the banking systems to reflect political preferences (Geddes, 1987, p. 100). By taking the lead on introducing Competition and Credit Control and greater reliance on market outcomes, the Bank was attempting to free itself of political pressure. The BoE also created a role for itself as a guardian and leader of the City.

The Bank of England helped re-establish London's competitive advantage in financial services through what it had not done, rather than anything it proactively did. By the late 1970s on the credit side the UK had five of the world's biggest banks headquartered in London, as well as a large share of the world's money and commodity traders (Geddes, 1987, p. 134). However, this masked what was fast becoming an unsustainable situation. The debt held by these London-based institutions was high, the London Stock Exchange (LSE) was slow and cumbersome and the banking industry began to lose prospects for growth as the UK's general economic performance was lacklustre.

The incoming Conservative government in the late 1970s had seized on the idea of increasing the UK's competitiveness, as such it instructed the Office of Fair Trading to probe

the restrictive practices of the LSE. Initially the BoE viewed this as an intrusion by government in an issue that was best left to City grandees to resolve (Geddes, 1987, p. 141). The political will, however, did not waiver and eventually this snowballed into the massive upheaval in banking regulation – the big bang.

The political interference was not limited to private banking competition and soon reared its head again. In 1973 interest rates were ripped from market control and the system reverted to the previous arrangement. This took place at the same time as a secondary banking crisis gripped the UK economy. The result was a questioning of the Bank's regulatory capacity and it was clear the Bank had not viewed supervision of the vastly increasing number of private banks as a priority task. There was relatively little in the way of checks and balances that prevented a business from gaining the title 'bank'. The secondary banking crisis was caused by a number of irresponsible bank boards acquiring a banking licence and engaging in reckless activity. The Bank's supervision team at the time consisted of 15 people (Geddes, 1987, p. 104).

In response the BoE created a bespoke Banking Supervision Department in 1974 with twice the number of staff and operating under the scrutiny of a deputy Governor. It has been noted that the culture of the Bank changed somewhat during this period, it relied less on the old City network and increased its direct demands for information from private banks, effectively dispensing with the Board of Trade self regulatory organisation (Geddes, 1987, p. 105). Also at this time, the BoE recognised an irreversible globalisation of banking was occurring and that supervision could no longer be dealt with on the basis of national borders. For the first time the Bank entered into supervision discussions with other central banks at the Bank of International Settlements (BIS), in Basel (Geddes, 1987, p. 105). The BoE took a lead role in convincing other central banks of the principle of *"parental*

responsibility" in banking supervision. This meant that each central bank would request confirmation from parent private banks that they would stand behind any banking subsidiary they owned in a time of crisis, whatever its operational location (Geddes, 1987, p. 105).

As a result of the secondary banking crisis and despite the changes implemented by the Bank, the government took the decision that statutory banking regulation was still essential (Pratten, 2011). The UK's first comprehensive statutory banking regulatory framework was introduced through the Banking Act 1979 (Quaglia, 2008b, p. 38). The Act strengthened the supervisory function of the BoE by placing it in charge of ensuring deposit taking firms were licensed and ensuring contributions to a deposit protection fund by regulated firms (Coleman, 1996, p. 187). The Act is portrayed by some as a victory for the Bank as it took on Whitehall, which believed supervision should be undertaken by a specialist government department, and won (Geddes, 1987). However, others, such as Quaglia (2008), take a different view. Arguing that after 1979, the Conservative government took control of monetary policy – regarded as the most prestigious element of central banking activity. Moreover, the proceeding Thatcher governments continued to reduce the autonomy and policy capacity of the BoE, albeit without any formal changes to its role (Quaglia, 2008b, p. 19). Government interference in the day-to-day duties of the Bank became frequent (Quaglia, 2008b, p. 19).

Throughout this period the political will to alter banking regulation did not falter. This time in the form of political will to improve the LSE (Moran, 1991, p. 70). It was a Labour government that initiated the inquiry into the LSE, however when the Conservative's took over office successive Trade Secretaries refused to drop the issue (Moran, 1991, p. 70). The Governor of the Bank took the decision that if upheaval was to take place the Bank should

be front and centre rather than standing by whilst politicians created chaos in the banking sector. Thus the Bank put the proposition to Whitehall that in return for the government dropping its fair trading case against the LSE and removing it from the Office of Fair Trading's jurisdiction, the BoE would oversee the necessary reform of the Stock Exchange. Eventually, in 1983 the Bank succeeded in convincing the Secretary of State for Trade, Cecil Parkinson, and LSE Chair, Sir Nicholas Goodison, to agree a deal (Geddes, 1987, p. 142). The LSE was given until October 27th 1986 to realise the reforms government felt necessary.

The Financial Services Act 1986 generated a major change in the BoE's supervisory power. The Act followed the Johnson Matthers Bankers' incident in 1984 which saw the private bank overstretch itself on loans to high net worth individuals which ultimately turned bad (Lawson, 1985). The legislation reinforced the BoE's role as supervisor of all banking institutions (Quaglia, 2008b, p. 39). On the securities regulation, the Act created the Securities and Investment Board (SIB). This Board, deemed a private institution, had the power to *"exercise statutory powers as delegated by the Secretary of State"* (Moran, 1991, pp. 58-9). The chairman and other board members of the SIB were appointed by the Secretary of State and BoE's Governor, in consultation with key City figures (Moran, 1991, p. 59). The SIB was largely designed as a body to write the regulatory rules, though it had some powers to initiate sanctions if needed. The SIB chose to delegate its licensing and minor supervisory tasks to self-regulatory organisations (SROs) (Moran, 1991, p. 59). The SIB, in turn, supervised these SROs.

This regulatory change resulted from high profile scandals related to private banks. In particular two cases stand out. In March 1981 an investment firm suffered bankruptcy owing £2.5 million (Pimlott, 1985, p. 146). The firm had invested clients' money in its own

companies which subsequently failed; leaving its client base with significant loses (Pimlott, 1985, p. 146). At the same time the Stock Exchange began investigating a firm of stockbrokers following allegations of money transfers to client accounts based on fictitious activity (Pimlott, 1985, p. 146). Furthermore, in the preceding months two firms collapsed in the City; one of which had deficits of £2.8million and client loses totalling £1.13million (Pimlott, 1985, p. 147).

At the time of these crises there was a blueprint for reform already underway. The publication of the White Paper that became the Financial Services Act 1986 was based upon two Gower Reports, published in 1982 and 1985 (Pimlott, 1985, p. 141). Gower was critical about the state of banking regulation, rejecting the '*caveat emptor*' approach and making a strong argument for more intrusive supervision led by the state (Gower, 1982, p. 15; Moran, 1991, p. 78). Gower undertook extensive consultation with banks regarding the regulatory framework; they expressed strong preference for maintaining low level supervision (Moran, 1991, p. 72). Gower also stated his objective was to ensure recommendations aligned with government policy, namely making London an attractive venue for banks (Pimlott, 1985, p. 150). Gower's main report favoured an agency created by statute, which would supervise the network of SROs. This report formed the basis of a government White Paper in 1985 and eventually the final Bill (Moran, 1991, p. 77).

4.2.2 Bank of England and Institutional Regulation (1997 – 2013)

In 1997 the newly elected Labour government made the decision to initiate wide-ranging reform of banking supervision (Bown, 1997). Supervision was given to a newly created agency – the FSA (Quaglia, 2008b, p. 40) (Black, 2010, p. 5). It is worth noting, whilst the BoE was stripped its supervisory responsibility, it gained operational independence in exchange. A major factor in the Bank gaining operational independence was the removal of

its supervisory capacity, as HM Treasury officials had been concerned about creating an institution that would be too powerful and unaccountable (Quaglia, 2008b, p. 21). It is worth noting that this was not the first time central bank independence had been considered by a UK government. In 1988, Conservative Chancellor, Nigel Lawson, directed HM Treasury officials to draw up plans for *"an independent but accountable central bank"* (Quaglia, 2008b, p. 19) (Conaghan, 2012, p. 16). However, the plan was eventually thrown out by Prime Minister Margaret Thatcher (Stephens, 1996, p. 277). Nonetheless, the announcement still came as a shock to economic and political commentators (Keegan, 2003, p. 154). In addition, Labour's 1997 reforms to the Bank included operational decisions being taken by a BoE Monetary Policy Committee (MPC), which could be overruled in times of severe crisis by the Chancellor (Keegan, 2003, p. 153) (Quaglia, 2008b, pp. 20-21).

The Bank itself had been preparing for some form of reform. It was widely regarded that the 1997 general election would see a Labour government replace the existing Conservative regime, with likely implications for the day-to-day operations of the BoE (Conaghan, 2012, p. 14). The Labour Party 1997 manifesto stated:

> *"We will reform the Bank of England to ensure that decision-making on monetary policy is more effective, open, accountable and free from short-term political manipulation"* (Labour Party, 1997).

The Bank was very much in favour of being removed from political manipulation. As long as the government of the day continued to set interest rates, the BoE was subordinate to Prime Ministers, Chancellors and HM Treasury officials (Conaghan, 2012, p. 14). The Governor, then Eddie George, along with his deputies Mervyn King and Paul Tucker, held a series of secret meetings with Labour's shadow treasury team in order to flesh out the

architecture of an independent BoE (Conaghan, 2012, p. 14). Mervyn King was a key player in drafting the architecture of the independent MPC. The BoE craved the type of independence that had long ago been granted to the Federal Reserve Bank, and had become frustrated with the Conservative government that acknowledged the idea of an independent central bank but lacked an incentive to turn the idea in to reality (King M. , 2005, p. 102) (Conaghan, 2012, p. 16). What is important to note about these meetings between the BoE and Labour Party officials is that whilst secret at the time from the public and markets, they were sanctioned by the incumbent Conservative Chancellor, Kenneth Clarke MP (Conaghan, 2012). The Governor of the BoE had sought clarification from HM Treasury regarding whether we could meet with opposition politicians (Conaghan, 2012, p. 17). As I will show in later chapters, no such request appears to have been made in the build-up to the 2010 general election when Governor King met with the opposition Conservative treasury team to discuss potential central bank reform. The BoE appears to be a highly effective lobbying body, in order to persuade the Labour government to follow through on central bank independence, the BoE suggested creating an "advisory committee" to advise government on monetary policy, when Labour won the election (Conaghan, 2012, p. 17). The BoE believed that if this worked well, it could convince the government to grant the BoE full autonomy on monetary policy (Conaghan, 2012, p. 17). Once the election campaign kicked-off, the BoE refrained from any public commentary.

The rationale for making the Bank independent was two-fold – and incorporates both economic rationale and political competition and strategy rationale. First, for many years the Labour opposition had watched powerlessly as successive Conservative Chancellors manipulated interest rates in election years. Removing HM Treasury from the decision-making process prevented this happening in the future. This in turn increased the Labour government's macroeconomic credibility – an issue it had suffered from in the past

(Goodhart C. , 2002, p. 194). Second, it insulated the Labour government from criticism when higher rates were required to curb inflation (Quaglia, 2008b, p. 21). It would now be able to point to independent technical experts as decision-makers on monetary policy.

The idea of making the BoE independent came from Gordon Brown's special advisor, Ed Balls, who had written a pamphlet on the importance of an independent BoE in 1992 for the Fabien Society (Keegan, 2003, p. 154) (Conaghan, 2012, p. 16). The fact that Balls was now an advisor to Brown had not gone unnoticed the BoE (Conaghan, 2012, p. 16). Whilst formulating the idea of CB independence, both Brown and Balls met with US Fed chair, Alan Greenspan, to discuss the implications of such a move (Keegan, 2003, pp. 156-7). Brown would let it be known that he had forged an alliance with Greenspan, as it enhanced his, and New Labour's, economic credibility (Rawnsley, 2010, p. 478). Greenspan told Brown that *"external pressures would inevitably"* result in CB independence being granted (Keegan, 2003, p. 157). Indeed the Fed was already an independent CB, and the European Central Bank, though in its infancy at this time, was being created as an independent institution. This warning from Greenspan played on the mind of Brown in particular, and eventually both he and Balls convinced Tony Blair, Labour leader, that it was better to get on the front foot and seize both the political initiative and moral authority on this policy decision, rather than become a victim of circumstance at a later date (Keegan, 2003, p. 157). Ultimately the discussions with Greenspan helped Labour conceive of a situation in which an independent central bank could work to the benefit of a centre-left government. Both Blair and Brown agreed that Labour could not win power unless they were able to purge it of the perception of financial failure (Rawnsley, 2010, p. 477). BoE independence mitigated this risk. In the words of Ed Balls, providing monetary policy independence to the BoE was an opportunity to ensure that a Labour government *"could do the things a Labour government should do"* without having to worry about a potential financial crisis (Keegan,

2003, p. 155). The decision to go ahead with central bank independence and alter the banking regulatory architecture was eventually only taken on the weekend before the 1997 general election. In fact, Brown instructed Balls to update plans for BoE independence and banking supervisory reform only on the Tuesday prior to the general election victory (Keegan, 2003, pp. 160-1).

As mentioned, in the build-up to the 1997 Brown and Balls held a series of secret meetings with Eddie George regarding the issues of increasing accountability and transparency of the Bank. However, the Shadow Chancellor did not mention stripping the Bank of its supervisory power until their first meeting following Labour's landslide election victory in May 1997. The impact of losing authority over banking supervision in 1997 cannot be understated. Those within the Bank at the time have stated it represented a loss of prestige and the then BoE Governor, Eddie George, seriously considered standing down in protest (Keegan, 2003, p. 159). However, Mervyn King, at this time Chief Economist at the BoE, was strongly in favour of the move (Interview6, 2012). Since gaining independence the Bank has invested heavily in buying-in expertise, with its research unit doubling in size between 1997 and 2003 (Quaglia, 2008b, p. 25). The BoE has the second largest number of employees with doctorates amongst its peers, and hosts the Centre for Central Banking Studies – which provides technical expertise and advice to other central banks (Quaglia, 2008b, p. 26). As a result the Bank has a prolific working paper publication rate. It is fair to say, the Bank prides itself on its expertise in all modern central banking functions.

The system put in place in 1997 was known as the tripartite system, involving HMT, the BoE and FSA. The FSA assumed the responsibility of the BoE's Supervision and Surveillance Division, the functions of which are outlined within the Banking Act 1987, chapter 22, sub-section 1 (1) (HM Treasury, 1987, p. 1). In addition, the powers relating to listing of money

market institutions and persons providing settlement arrangements, under the Banking Coordination Regulations 1992 and section 101 (4) of the Building Societies Act were also transferred from the BoE to the FSA (Ojo, 2012, p. 3). Under the new system, HMT would produce statutory instruments of regulation under legislation, all contained within the Financial Services and Markets Act 2000. The FSA, as principle supervisor, was accountable to HMT and Parliament through written and oral evidence submissions as well as audit reports (Black, 2010, p. 5). The predominant role of the BoE was to manage monetary policy. This was fulfilled by producing regular macroeconomic outlook reports and keeping a watching brief on the overall financial stability of the UK economy, including the stability of private banks (Black, 2010, p. 5). A deputy Governor of the BoE also sat on the Board of the FSA and, likewise, the Chairman of FSA become a member of the Bank's court (Black, 2010, p. 6). The arrangement was codified through a Memorandum of Understanding between the three institutions.

It is important to understand the events that led to the BoE to losing supervisory responsibility in 1997. There were a series of major supervisory failures in the early 1990s, for which the BoE was deemed ultimately responsible (Hindmoor & McConnell, 2014, p. 6). The SIB and SROs failed to spot the pensions fraud committed by the Maxwell empire (Westrup, 2007, p. 1099). The system, amended in 1986, came under further scrutiny following a major pension miss-selling scandal. This supervisory element of reform was unexpected by the Bank, given in opposition Labour assured the Bank officials that it had no interest in altering supervisory arrangements (Quaglia, 2008a, p. 450). The BoE's ability to supervise the banking system came into question as a result of the Bank of Credit and Commerce International (BCCI) collapse in 1991 (Mayes, Halme, & Liuksila, 2001, p. 1). Subsequent enquiries claimed the BoE '*deliberately ran away from seeking sufficient information...because it didn't want to be drawn into the role of supervisor*' (BBC, 2004). In

addition the Treasury Select Committee (TSC) concluded the BoE failed to implement the law as required (Treasury and Civil Service Committee, 1993, pp. 7-8). The inquiry also criticised self-regulation as the Bingham Report stated '*supervisory law... creates conditions hostile to the growth of fraud and friendly to...early detection and eradication*' (Treasury and Civil Service Committee, 1993, p. 5). The BoE's ability to resist change had been diminished by past failures and the public nature of criticism of its role (Quaglia, 2008a, p. 451).

The BCCI affair was a high profile embarrassment. However, worse was to follow as 1995 saw the collapse of Barings Bank – the UKs oldest bank (Hindmoor & McConnell, 2014, p. 6). Barings was purchased for £1 after running up debts equivalent to its entire assets (BBC, 1999). Another huge failure of supervision on the BoE's watch further diminished its ability to veto change (Quaglia, 2008a, p. 452). Once again the regulatory framework failed to spot a banking collapse and shock to the markets. Creating the FSA was a response to this latest supervisory failure (Quaglia, 2008b, p. 21). The FSA was assigned supervisory responsibility for the entire financial industry (Mayes, Halme, & Liuksila, 2001, p. 57). This operational change altered the '*relationship between the British state and financial markets*' (Westrup, 2007, p. 1099). In legal status the FSA was very similar to that of the SIB. The FSA was created as a non-governmental institution funded through a levy on those it regulated with a board made up of bankers (Westrup, 2007, p. 1099).

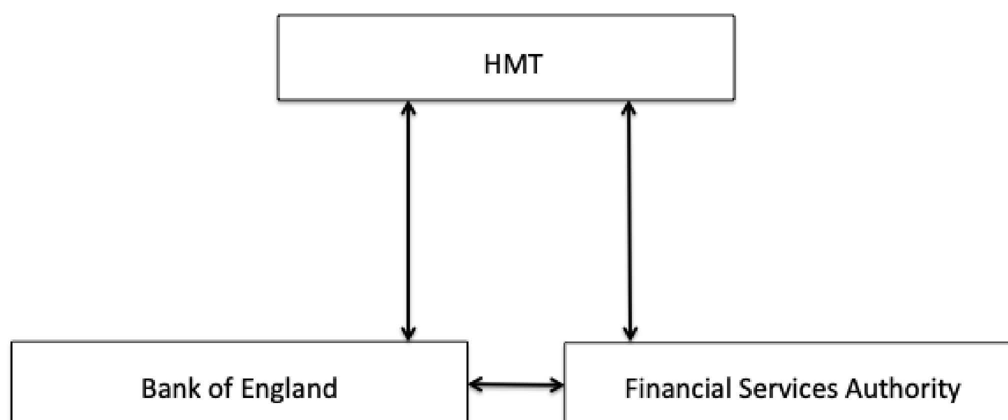
The more significant changes were contained within the FSA legislative remit, increasing its accountability. Parliament could make amendments to the '*primary legislation*' that affects the FSAs day-to-day operations (Westrup, 2007, p. 1099). Parliament could also debate any work of the FSA via questioning the Chancellor, whilst the TSC could do likewise – summoning the FSA to appear before it (Sykes & Allen, 2005, p. 156). The hierarchy of the

FSA was appointed by the Chancellor. At the same time as the FSA was created so too were statutory consumer groups, who were to be consulted on changes to regulation (Sykes & Allen, 2005, p. 157). This system remained in place until after the 2008 financial crisis.

Gowan suggests that the result of the regulatory changes in the late 1990s saw relationship between London and New York become the equivalent to that of Guantanamo Bay and Washington DC (Gowan, 2009, p. 16) (Lastra, 2009, p. 135). As one PB put it:

> *"...the UK was seen by the US banks more as an off-shore type venue under the FSA"* (Interview9).

Figure 2: UK regulatory architecture 1997-2012/13:

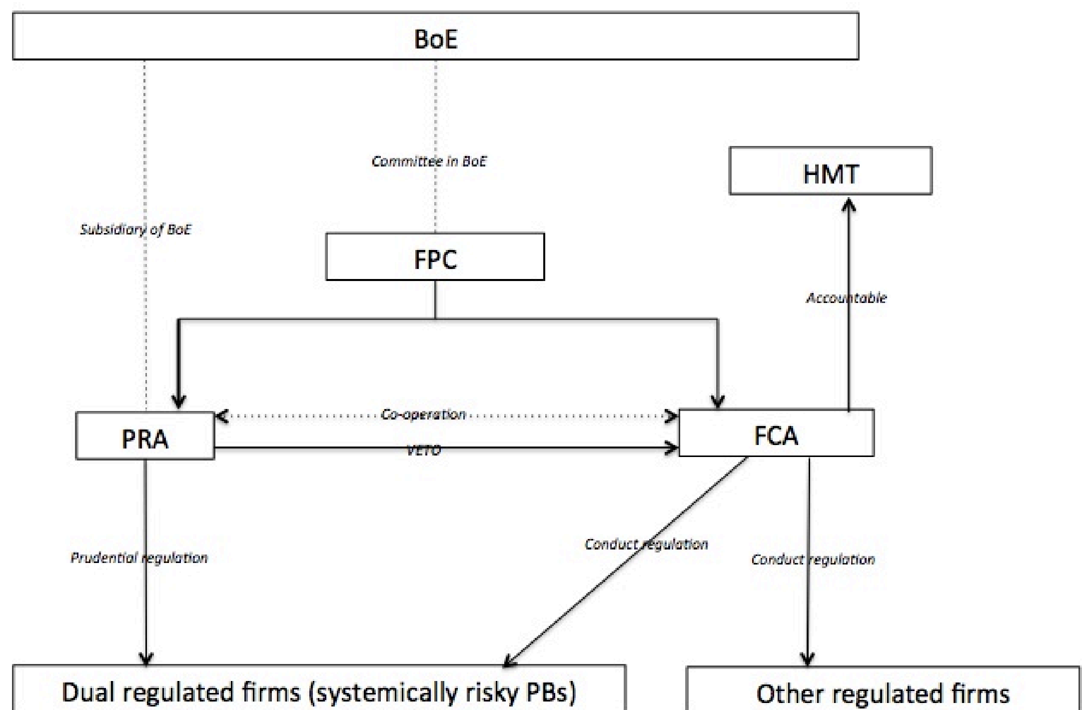


4.2.3 Bank of England and Institutional Regulation post 2012

The next major change to the BoE and the UK's regulatory architecture, and the subject of this research, came during the post 2008-crisis fallout. On 1 April 2013 the Financial Services Act 2012 came into force, removing the Financial Services Authority (FSA) from the scene and delivering a new regulatory structure for the UK, comprising the Prudential Regulation Authority (PRA), Financial Policy Committee (FPC) and the Financial Conduct Authority (FCA). The Bank now oversees supervision of the financial system and its financial policy committee (FPC) directly instructs the supervisory arms. The FS Act ratified the BoE

Governor with *"executive powers...chairmanship of committees setting monetary policy, system-wide financial rules, and the supervision of individual banks..."* (Giles, 2012). Under the reforms, the BoE Governor will now serve one eight year term, rather than renewable four years terms, thus as an individual he/she has more autonomy not less. Many of the BoE's policy decisions, such as operations to provide funding for banks, are still made outside policy committees.

Figure 3: UK Regulatory architecture post-institutional reform



4.3 The US Federal Reserve System

The US Federal Reserve system was founded in 1913 with President Woodrow Wilson signing the Federal Reserve Act 1913. In tune with the institutions of government in the USA, the founders of the Fed were concerned with not concentrating too much power in one place. As a result the Fed was created as a decentralised central bank spread over twelve districts. The Federal Reserve System, and America's first central bank, was a regulatory response to the banking crisis of 1907 (Moran, 1991, p. 28) (Wood, 2015, p. 64).

Its primary function was to ease demands for liquidity across the US through its decentralised system (Calomiris, 2010, p. 547).

4.3.1 Origins of the Fed 1906-1917

The birth of the Federal Reserve System was itself the outcome of a financial crisis (Cooley, Schoenholtz, Smith, Sylla, & Wachtel, 2010, p. 51). Reform of the US banking regulatory system and the creation of a national central bank did not gain traction until a liquidity crisis, caused as a result of the 1906 San Francisco earthquake. (Krieghoff, 2013, p. 36). The magnitude of the crisis that followed in 1907 was significant enough to create strong advocates for banking regulatory reform. Private banks themselves were crucial in securing the creation of a central bank as they sought some form of government protection from riskier activity of peers and exposure to non-banking entities (Frydman, Hilt, & Zhou, 2012, pp. 8-10). In essence they wanted to form a lender-of-last-resort.

Following the 1907 panic, Congress opened two major commissions to address the problem. First, the National Monetary Commission (NMC) was convened to examine the role a central bank could have played, and indeed was playing in other countries, during an economic crisis (Federal Reserve Archive, N.D). The NMC was made possible by the Aldrich-Vreeland Act, which in addition to establishing the NMC, also allowed for the use of temporary currency during crisis situations (Wood, 2015, p. 65). This facility was utilised on only one occasion before the legislation lapsed – to counter foreign currency withdrawals following the outbreak of the First World War (Wood, 2015, p. 65). The NMC concluded that whist private banks behaved rationally during the crisis by cutting back on lending, this caused US money markets to come to a stand still. Larger New York based banks had attempted to kick start lending, but they obviously lacked the capacity to print currency (Krieghoff, 2013, p. 37). The recommendation of the NMC was eventually the creation of the Federal Reserve

(Wood, 2015, p. 65). The Federal Reserve System created as a result of the NMC's report lacked a decision-making body, but could act as a lender-of-last-resort and conduct open market operations. At this time the US system had a clearer distinction between national banks and state banks. National banks historically have been the big commercial banks and were automatically members of the Fed. Other banks thus did not necessarily have access to the lender-of-last-resort function. The national banks were also subject to regulation by the Comptroller of Currency. Though upon the Feds creation it used the option of access to the lender-of-last resort function to entice all banks to become members. In order to encourage more state banks to subject themselves to the Fed's regulatory code an amendment to the Federal Reserve Act was passed in 1917. This allowed state banks to retain their business model whilst becoming members of the Fed so that the US could mitigate future banking failures (Federal Reserve Board, 1932, p. 240). However, in practical terms this meant state banks were not subject to the same level of regulatory oversight as national banks.

The second commission setup by Congress was the Money Trust Inquiry. The Inquiry sought to identify the nature and impact of powerful Wall Street influence on the conduct of banks. It recommended that there should be a separation between investment and retail deposit activity of banks. However, its recommendations went unheeded by Congress (Krieghoff, 2013, p. 40).

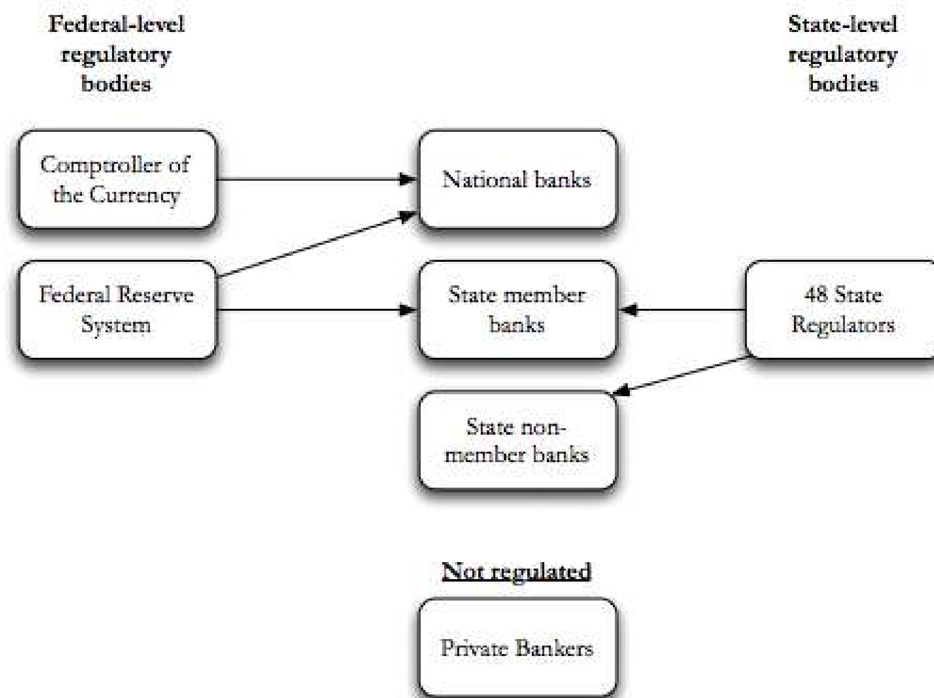
The ideational influence on the design of the Federal Reserve System predates the NMC. Senator Aldrich had previously advocated the formation of a series of voluntary National Currency Associations to issue currency via business and railroad bonds within specific localities to ease liquidity concerns as and when they arose (Wood, 2015, p. 65). However this was rejected by western US banks that feared it was simply the creation of a securities

market for securities held by New York rivals (Wood, 2015, p. 65). Aldrich attempted a more ambitious Bill in 1912, along with investment bank Paul Warburg (Wood, 2015, p. 65). The Aldirch/Warburg Bill more closely resembled the first Federal Reserve Act, but was not passed as Republicans lost control of both Houses between 2010-12, and Democrats opposed the Bill (Wood, 2015, p. 65). Despite this setback, the commercial banking sector remained pro-reform, though did not favour the creation of a traditional central bank that competed with private banks (Kolko, 1963, p. 226) (Glass, 1927, p. 80). Rather they favoured a central bank that would lend to commercial banks in times of distress (Wood, 2015, pp. 65-67). In the Senate, Carter Glass picked up the reformist mantel. Glass rejected Aldrich's idea of a central board, as Glass favoured an arrangement that would break Wall Street dominance over the industry (Willis, 1915, pp. 142-43). However, President Wilson demanded a centralised board that could coordinate and control the system of reserve banks (Wood, 2015, p. 67). The result of the negotiation was the Federal Reserve Act 1913.

Overall the Federal Reserve Act had something for everyone. It was the commercial banks though, that gained the most. They now had a public institution that bore the burden of the nations reserves. National banks, though mandated to join the Reserve System, enjoyed discounted Reserve rates. In addition, but changing a national bank's charter to that of a state bank, they could avoid membership altogether (Wood, 2015, p. 67). This was because state banks' membership of the Reserve System was voluntary.

The diagram below illustrates the nature of regulatory arrangements in the banking sector between 1917 and 1932.

Figure 4: US institutional arrangements 1917-32. Source: (Krieghoff, 2013).



4.3.2 The Fed and banking reform 1918-29

Whilst no meaningful reform took place during this period, it is worth noting that regulatory debates still occurred regarding how to deal with the banking sector, particularly given the increasing level of bank failures in the build-up to the 1929 Wall Street Crash. There were a number of instances in which members of Congress attempted to abolish the Comptroller of Currency and transfer its capabilities to the Fed. Ultimately, the Bills introduced to engineer this never made it through Congress (Krieghoff, 2013, p. 41). This period of the Fed's history is also viewed, through the lens of contemporary history, as a period in which the Fed "sowed the seeds of the Great Depression" as it sought to double money and prices from 1914-1920, which under the gold standard had to be reversed (Wood, 2015, p. 70).

Another area of debate was around the issue of lifting the ban on bank branches to allow larger and more stable banking institutions to be created. (Krieghoff, 2013, p. 41). This gave rise to the McFadden Bill, introduced to Congress in 1924. The Bill was designed to stop the increasingly popular conversion of national banks into state banks. The Bill proved highly controversial and was not passed until 1927. This was in part due to concerns over the impact on the Fed system. If regulation were too tough on national banks, they would convert to state banks and withdraw from the Fed system (Krieghoff, 2013, p. 43). The compromise Act that was passed provided minor relaxation of the branch rules, allowing both state and national banks to open branch networks within their home cities (Krieghoff, 2013, p. 43).

4.3.3 Reform post-Wall Street Crash 1930-35

The Fed's response to the Crash is widely accepted to have been a strong contributing factor to the depth of the Great Depression that followed through its strict adherence to the doctrine of 'real bills', which saw it limit liquidity. It has been a subject of much academic attention (Wood, 2015) (Friedman & Schwartz, 1963) (Bernanke, 2002).

A number of Congressional hearings between 1932-34 created an environment in which Roosevelt's first administration could reform banking regulation. The regulation was tough – splitting banking and securities markets in two, with banks prevented from engaging in the riskiest elements of the securities markets (Moran, 1991, p. 28). There was a strong coalition that supported centralising banking regulation under the Fed (Burns, 1974, p. 12). The Fed was even asked to put forward a *"constitutional method of bringing about the establishment of a unified system of banking under national supervision"* (Krieghoff, 2013, p. 45). During this period the Fed pushed relatively hard for this centralisation of regulatory authority to take place (Krieghoff, 2013, p. 46). However, the campaigning window for the

upcoming 1932 presidential election, which caused a large degree of partisan-led stalling, cut negotiations short. The large-scale bank runs that took hold in 1932 then shut the window of opportunity for Fed-specific reform.

The discussions that had taken place throughout the 1920s allowed Congress to act swiftly in 1932, and the Glass-Steagall reforms were passed in summer 1933. The idea of separation between retail and investment banking was this time passed through the reforms, twenty years after it was first discussed. In addition, Glass-Steagall also introduced depositor insurance. Instead of placing the Fed in charge of the scheme, thereby centralising banking regulation, the Act instead created a new regulatory agency: the Federal Deposit Insurance Corporation (FDIC) (Calomiris, 2010, p. 542). The Banking Act 1933 and 1935 allowed the Fed to conduct open-market operations and reserve requirements. It also ensured that the Treasury Secretary and Comptroller of the Currency were removed from the Federal Open Market Committee (Calomiris, 2010, p. 551). This created a new level of authority for the Fed. During this period the influence of the banking industry on reform is deemed to have been high – it had capital, control of media and a coalition of Congressional advocates – all hallmarks of the business elite (Moran, 1991, p. 31). The result was that the commercial banking industry was able to bat away many more radical attempts at regulatory reform in favour of SROs (Moran, 1991, p. 31).

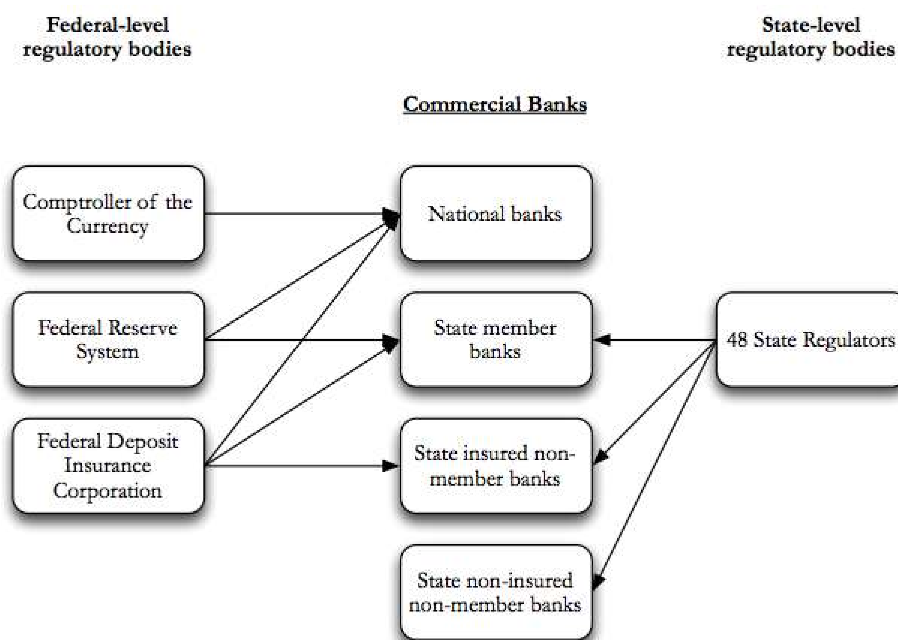
In terms of the regulatory system in place and its interplay with the Fed, the institutions created following the aftermath of the Great Depression amounted to a licence to self-regulate granted by the state (Moran, 1991, p. 21). The US system of banking regulation has historically been unique in its degree of fragmentation, which results in banking regulatory powers being spread over a number of institutions. In the Fed's formative years private banking interests controlled the regulatory machinery (Moran, 1991, p. 21). However, this

changed significantly following the events of the Wall Street Crash, which Fed stats show resulted in a 39% contraction in the number of US banks between 1929-33 (Calomiris, 2010, p. 541). Interest payments by banks on regular deposits were also heavily regulated – with interest payments in most cases being banned. The innovative financial instruments thought to have led to the crash were outlawed.

The reforms also provided a greater incentive for all commercial banks to become members of the Fed system by repealing the requirement that state banks only needed to hold 60% of the capital required by comparable national banks for Fed membership (Maues, 2013). The architects of the Act have been accused of implicitly endeavouring to create a system of centralisation to Fed regulation (Krieghoff, 2013, p. 50).

The impact on the Fed was a reorganisation designed to reduce the influence of private banking authority on the regulatory system (Moran, 1991, p. 29). The Securities and Exchange Commission (SEC) was created, as a New Deal agency, to oversee a network of SROs. It has been suggested that at this time the SEC suffered in terms of expertise, given all those with knowledge of the securities market were employed by commercial banks (Moran, 1991, pp. 30-31) (Wells, 2000, p. 197). The reforms represented a dramatic increase in Federal intervention in the banking industry. The SROs had to be formed at this time, given that all expertise at this juncture tended to be in the private sector rather than public agencies.

Figure 5: Post 1930 institutional arrangements. Source: (Krieghoff, 2013)



The regime put in place post-1930 in the US was designed to regulate American financial markets (Moran, 1991, p. 33). However, as with the UK regulatory history, the growth of the Eurodollar market changed the face of regulation in the US again during the 1960s and 70s. Between the 1930s and 60s the regulatory state agencies, in particular the SEC and Fed, had built-up considerable expertise of their own and gained prestige as institutions (Moran, 1991, p. 35). Overtime the SEC and Fed became *"stronger"* than the interests they were regulating (Moran, 1991, p. 35). At the same time the SROs created by the New Deal were less controlled by bankers – who had become too busy with a banking boom and more dominated by regulatory lawyers that undertook the supervisory work on behalf of the banking industry (Moran, 1991, p. 35). The fact that a new professional class of regulatory specialists now existed contributed significantly to regulatory changes that took place during the 1970s and 1980s.

The New Deal banking reforms of the post-depression era had ushered in a new paradigm of relative stability in the banking sector. However, this occurred at a cost, like in the UK, the

US banking market had become less competitive (Moran, 1991, pp. 40-49) (Sylla, 2008). At the same time innovation in financial services saw a range of unregulated institutions create new options for depositors that produced higher returns.

4.3.4 US Banking reform (1960s-2007)

In 1968 the increases in technology in the securities industry made it increasingly difficult for the New York Stock Exchange to cope with processing transaction volumes (Wells, 2000, p. 201). The result of the backlog was the 1975 Securities Amendments Act, strengthening the role of the SEC (Moran, 1991, p. 46). The liberalisation of the 1970s and 1980s saw the emergence of a number of new regulatory Acts. A new federal agency was created in 1974 to deal with the growing futures market, the Commodity Futures Trading Commission. The International Banking Act 1978 provided federal control of foreign-owned banks operating in the USA (Moran, 1991, p. 46). The 1980 Depository Institutions and Monetary Control Act repealed ceilings on interest rates (Sylla, 2008). The Act also made membership of the Fed compulsory for all deposit taking institutions in the US; this was the first time this had happened (Moran, 1991, p. 46). Moran documents that throughout this period there was a regulatory theme that placed emphasis on a "*super regulator*" that could better centralise the de-centralised nature of US banking regulation (Moran, 1991). However, this did not ultimately transpire.

As the financial services boom continued, so did the deregulatory agenda. In 1999 the Gramm-Leach-Bliley Act was passed, overturning the Glass-Steagall Act of 1933 and allowing banks to offer a menu of financial services, including investment banking and insurance (Woll, 2014, p. 84).

4.4 Conclusion

Unlike the United States, where the structure of financial regulation was largely established in the aftermath of 1929, regulation in the UK evolved more organically. Since the outbreak of the financial crisis in late 2007, many changes to Western advanced economy central banks have taken place, which have yet to be adequately assessed in theoretical terms within the political economy literature (Lebaron, 2008, p. 121) (Bowman, et al., 2013, p. 456). Their roles within the polities they operate have become increasingly important and high-profile.

Throughout this history of central banks and banking regulation and supervision, in particular in the US and UK, it tends to be the case that the preferences of the financial community tend to influence policy-makers the most. Thus the commercial banking sector tends to end up with the type of regulatory arrangements that it wants (Bell & Hindmoor, 2015, p. 4). Eventually, overtime in the US the "*attitude took hold that what was good for Wall Street was good for the country*" (Johnson S. , The Quiet Coup, 2009c). Similarly in the UK, when new Labour came to power Ed Balls as a junior HMT minister asked bankers "*what more can I do…to support the critical role the banking industry plays in our economy?*" (Bell & Hindmoor, 2015, p. 4). There was an implicit assumption on the part of policy-makers that the industry had expertise and would make the best decisions (Bell & Hindmoor, 2015, p. 4).

The brief histories of the central banks that concern this research highlight the fact that there has often been a fractious relationship between central banks and the political classes (Langdon, 1961, p. 527). For example, the BoE during the 1980s and again in the mid 1990s underwent changes in independence and authority. There have also been instances in which there were movements towards centralising banking regulation within the US Fed. Indeed, the idea of empowering the Fed as a centralised banking supervisory is not a new one, it is a

theme that has been present throughout its history. At various junctures in the histories of each of these central banks we have seen the promotion of expert ideas, political competition and bureaucratic politics seemingly play important roles in their relationships with the banking system.

Chapter 5. The Federal Reserve Board and post-crisis reform

5. 1 Introduction

The worst global financial crisis in living memory began in the United States (US). The incumbent Republican Administration allowed Lehman Brothers investment bank to fail on 12 September 2008. By 16 September 2008, the Federal Reserve (Fed) had provided an $85 billion two-year loan to AIG to prevent its bankruptcy and further stress to the US and global economy (Clark, 2008). Financial institutions experienced losses of $1.1 trillion. Congress committed funds equal to 30% of GDP to support the financial sector, whilst the Fed initiated a series of measures to prevent full-scale meltdown of the US economy (Lipscy & Takinami, 2013, p. 340) (Schildbach, 2010).

The immediate aftermath (2008-2010) prompted institutional reform of banking regulation. The Dodd-Frank Wall Street Reform Act 2010 (DF Act) was the United States' regulatory response to the crisis. This institutional reform increased the macroprudential and micro prudential authority of the Fed (Goodhart, 2014, p. 281) (Cooley, Schoenholtz, Smith, Sylla, & Wachtel, 2011, p. 51) (Michel N. , 2014) (Jacobs & King, 2016, p. 151). Counter-intuitively this occurred despite the central bank being deeply unpopular amongst the electorate and politicians.

The DF Act was signed into law on 21 July 2010. First, it created a new macroprudential institution layered on top of the existing architecture, which then delegates responsibility for micro prudential supervision of systemically important firms to the Fed. Second, the DF Act increased the Fed's micro supervisory authority to cover all systemically important non-bank firms. Third, it removed consumer protection regulation from the Fed and created America's first consumer financial protection bureau (the CFPB). Finally, it restricted the

Fed's autonomy over its lender of last resort (LOLR) capability. The institutional reform process proved highly contentious and was heavily laden with veto points.

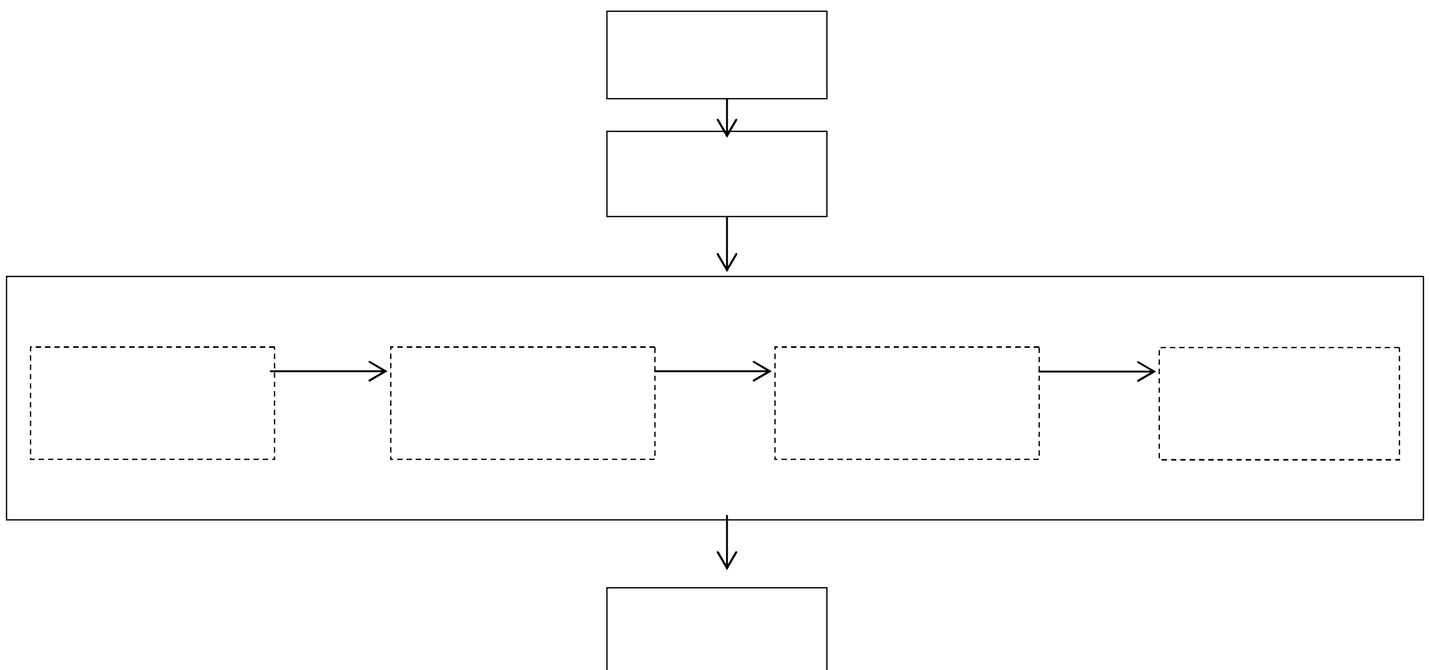
Table 7: institutional reform enacted by the Dodd-Frank Act.

Capability	US Structure post institutional reform
Macroprudential policy-making	Federal Reserve Board[5]
Macroprudential oversight	FSOC (Chair: Treasury Secretary)
Micro prudential supervision	Shared by multiple agencies

This case study disaggregates the process of institutional reform into four negotiations that were played out in multiple arenas, involving multiple actors. I argue that institutional change in the Fed's macro and micro prudential capabilities can only be understood when viewed through the lens of negotiations played out between the legislature, several regulatory bureaux, and the financial services industry. Interactions between these actors take place within political institutional constraints, and this has a bearing on the potential outcomes (P_1). The four subsequent negotiations are played out via the issues of macroprudential reform, micro-supervisory reform, consumer protection and central bank independence. The implication of this is that the preferences and strategies of the players in each negotiation are, to an extent, reconfigured as a result of institutional constraints. This is modelled below:

[5] Macroprudential powers for supervising systemically important financial institutions are delegated by FSOC to the Federal Reserve.

Figure 6: The ACI framework applied to US post-crisis supervisory reform.



This chapter proceeds as follows. The second section explains the preferences of the actors involved in the institutional reform process. The third section places the reform in context by reviewing the political landscape in which the preferences are grounded. The case study disaggregates the reform process into four negotiations – macroprudential, micro prudential, consumer protection, and central bank independence – and traces the process that led to the institutional reform outcome. The final section considers the institutional reforms against the main and alternative propositions.

5.2 Preferences, Players & Pay-offs

The ACI framework requires the identification of the set of interactions that are to be explained. This allows for identifying the actors that are actually involved, and whose choices will ultimately determine the outcome (Scharpf, 1997, p.43). Actors are assumed to be capable of purposeful choices among alternative courses of action (Scharpf, 1997, p.7). They are assumed to be rational in the sense that they will attempt to maximize their own

self-interest; but they are not assumed to be entirely rational. The issue of banking regulatory architecture is mainly of interest to the financial community, government, political parties, and consumer groups. The financial crisis constituted an exogenous shock, triggering a dramatic shift in regulatory preferences; this section outlines the preferences of the key actors at the outset of the institutional reform process.

5.2.1 Financial Industry Lobby

Historically the US has passed stringent financial regulation laws, such as the Glass-Steagall Act 1933 (Woll, 2014, pp. 83-84). . However, since the 1980s the industry's influence has grown (Witko, 2016). This is not simply because their profitability generates economic returns which allows them to wield structural and instrumental power (Bell & Hindmoor, 2017, p. 105). The US banking sector represented less as a percentage of GDP than the UK banking sector when the crisis struck (House of Commons, 2019). The influence of the US banking sector is also a result of political institutional constraints that force US politicians to raise their own campaign funds. Wealthy industries such as financial services often offer a reliable source of income. Firms can donate significant sums to individual politicians or control good economic outcomes through business lending. It stands to reason, then, that politicians seeking re-election maybe be sympathetic to the preferences of the financial services lobby.

The financial services lobby in the US is characterised by factionalism (Woll, 2014, p. 83). . Different groups of financial firms (large retail banks; investment banks; community banks) can have different preferences regarding the same policy issue (Interview26, 2016) (Interview30, 2016) (Interview40, 2016). Broadly speaking, the financial industry lobby sought to retain the status quo so as not to diminish arbitrage opportunities.

Firms had a preference for macroprudential reform, because the optics of a greater focus on financial stability post-crisis tends to have a positive impact upon market stability. However, firms of varying types had concerns over centralising power within the central bank. Therefore each faction had a preference for a multi-agency macroprudential council. Micro-supervisory reform impacts all firms, and each firm type had a strong preference for maintaining the status quo arrangements.

5.2.2 Political actors

Following the 1929 Wall Street crash politicians followed a path of punitive and restrictive financial regulation. Since the 1980s, as the de-regulatory agenda took-off, US mainstream politicians have been cheerleaders for financial de-regulation (Sherman, 2009, pp. 1-2) (Witko, 2016). The crisis, however, exposed the vulnerability of the US economy to a financial services industry that had become 'too big to save'. This resulted in individual politicians having to re-assess their positions on banking regulation. In the US, a number of political actors' preferences are important to the institutional reform process, and these are detailed below:

Presidential candidates

Over the previous decade the Republican candidate, Senator John McCain, had backed the de-regulatory positions and economic policies enacted by the incumbent Bush Administration (Shear, 2008). McCain was unable to articulate a clear alternative institutional arrangement post-crisis (Henninger, 2008) (Holcomb, 2013). Thus his preference on institutional reform is assumed to be in favour of the status quo.

In contrast, Barack Obama was committed to reforming the regulatory architecture post-financial crisis. The Obama Administration's preference was to empower the Fed with macroprudential capabilities whilst also consolidating the number of agencies involved in

financial regulation[6] (Fifield, 2010) (Geithner, 2014, pp. 400-401). (Interview29, 2016) (Interview30, 2016) (Interview31, 2016). The Obama Administration also held a strong preference for the creation of a new independent and powerful consumer protection agency.

Treasury Secretary, Tim Geithner, and Director of the National Economic Council, Larry Summers, influenced the Obama Administration's preferences (Skeel & Cohan, 2010, p. 46) (Interview38, 2016) (Interview34, 2016) (Interview32, 2016) (Interview31, 2016). Secretary Geithner served as New York Reserve Bank President prior to joining the Treasury. Geithner had great faith in the expertise and capabilities of the central bank. Geithner championed the role of the Fed within the Administration (Braithwaite & Guerrera, 2009) (Interview29, 2016) (Interview30, 2016) (Interview31, 2016) (Interview32, 2016) (Interview34, 2016). In addition, the Treasury wished to exert greater control over macroprudential decision-making. The lack of political control in 2007/08 limited the Treasury's ability to react to events efficiently (Department of the Treasury, 2008, p. 143). Secretary Giethner stated:

> *"We cannot build a system that depends on the wisdom and judgment of future regulators"* (Fifield, 2010).

Legislature

Political parties in the US are characterised by high levels of factionalism. Therefore it is less likely that political parties in the legislature will vote in complete unison on any given policy issue. However, broadly speaking Congress sought to use post-crisis institutional reform for electoral gain (Jacobs & King, 2016, p. 142) (Shear, 2008) (Interview40, 2016) (Interview38, 2016) (Interview30, 2016) (Interview32, 2016). For Republicans this meant attempting to veto institutional reform to prevent Democrats claiming credit for reform during November

[6] The agencies involved in US financial regulation pre-crisis are outlined in chapter xx

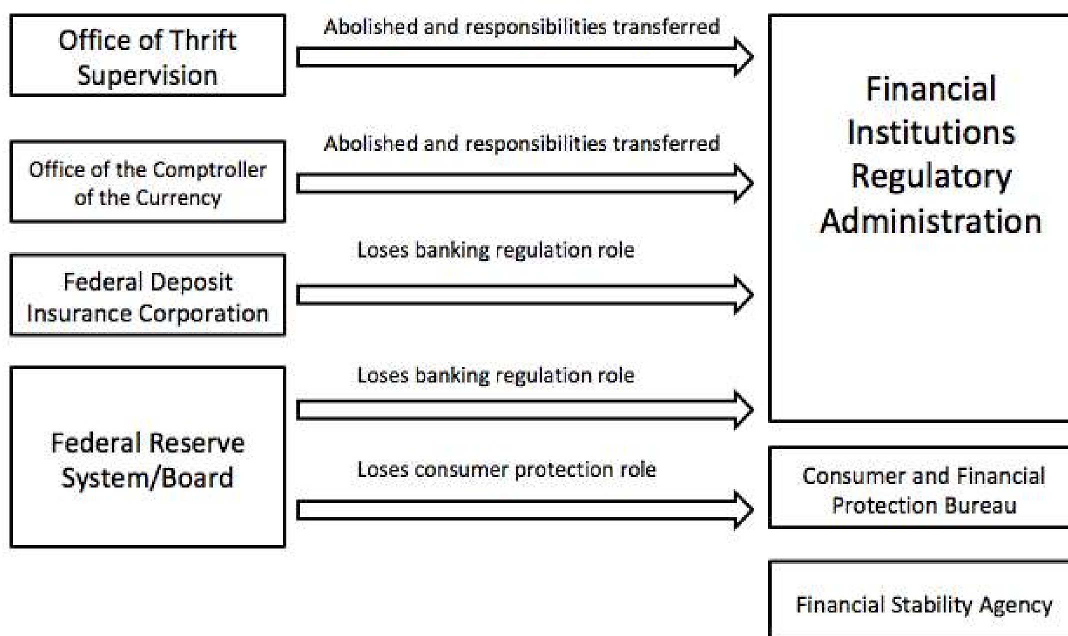
2010 mid-term elections. For Democrats this meant enacting institutional reform in order to demonstrate significant action ahead of November 2010 mid-term elections.

Yet politicians on both sides had a preference for punishing the Fed, using institutional reform as a vehicle. Politicians deemed the central bank culpable for the crisis. The Fed was perceived as the senior bureau overseeing the banking sector when the crisis hit. It was the most visible bureau during the crisis management phase. Politicians needed to be seen to punish poor the performance of the bureau and were, to an extent, hostages of public opinion (Jacobs & King, 2016, pp. 142-3) (Goodhart, 2014, p. 284). This anti-Fed sentiment was split across party lines. Republicans were irritated that the Fed had acted independently to save AIG from collapse (Goodhart, 2014, p. 284). The Republican preference was to prevent the Fed circumventing Congress in the future. Democrats, in contrast, wanted to claim credit for re-inventing consumer protection; their overriding preference was therefore a recalibration of consumer protection regulation in the form of a new independent agency (Goodhart, 2014, p. 284) (Jacobs & King, 2016, p. 38) (Interview30, 2016) (Interview32, 2016) (Interview31, 2016). Democrats blamed the Fed for not using its powers under the Home Owners Equity Protection Act 1995, to protect borrowers from poor lending practices (Goodhart, 2014, p. 284).

The Democratic Party controlled both the House and Senate of Congress from January 2008 until the institutional reform process was completed. The key figure within the House of Representatives was the Democrat Financial Services Committee Chair, Barney Frank. Frank was generally aligned with the Administration's preferences (Skeel & Cohan, 2010, p. 46). The key actor orchestrating the Senate's response was the Democrat Banking Committee Chair, Christopher Dodd. Dodd had a preference for reinventing the Fed as a monetary policy agency (Skeel & Cohan, 2010, p. 46) (Masters, Braithwaite, & O'Connor, 2009).

Dodd's radical version of institutional reform involved transferring supervisory authority from all existing bureaux into a new independent micro prudential regulator; and establishing a new independent macroprudential regulator. Factional splits between Democrats meant that the governing Democratic Party was split between two types of intuitional reform – the Administration's vision and Dodd's version.

Figure 7: Senator Dodd's full proposal for institutional reform. (source: created by the author from numerous interview accounts and articles on Dodd's initial proposals).



5.2.3 Federal Reserve System

The Fed is an independent central bank. Its decisions are not subject to political control. Its overriding preference was to survive the institutional reform process without compromising its existing capabilities or autonomy (Bernanke, 2015, p. 442) (Bernanke, 2009d, p. 24) (Interview29, 2016) (Interview31, 2016) (Interview30, 2016) (Interview38, 2016)

(Interview40, 2016) (Interview34, 2016).[7] Beyond this, the Fed developed a strong preference for gaining macroprudential authority (Baker, 2013) (Goodhart, 2014) (Bernanke, 2015, p. 442) (Interview34, 2016) (Interview40, 2016)(Interview34, 2016).

5.2.4 Financial Regulatory Bureaux

The most important of the myriad financial sector regulators in the US throughout the reform process were the: Federal Deposit Insurance Corporation (FDIC); Securities and Exchange Commission (SEC); and Commodity Futures Trading Commission (CFTC). These bureaux entered the reform process with a preference for maintaining their pre-crisis authority (Interview29, 2016) (Interview33, 2016) (Interview31, 2016) (Interview30, 2016). Each agency sought to ensure that it did not become subservient to the central bank as a result of macro or micro prudential reform. No smaller agency was advocating expanding its micro supervisory remit. This is rational given it is a high-risk activity with low levels of reward.

5. 3 A Financial crisis, 2008 general election & shaping actor preferences and strategies (February 2007 – November 2008)

The ACI framework recognises that the socio-economic context constitutes an important exogenous source of change, which can (re-)shape the nature of strategic negations. One mechanism through which this may occur is in response to economic crises, which alter the electoral incentives facing politicians. In response, political actors in the institutional reform process will re-evaluate and adjust their preferences and strategies in order to maximise the electoral pay-off they anticipate from voters.

On 27 February 2007, the warning signs of a financial crisis began to crystallise, as Freddie Mac announced it would no longer buy sub-prime mortgages and mortgage-backed

[7] The Federal Reserve System already had significant supervisory responsibility for the US banking sector at the time of the crisis – albeit through its subsidiary Reserve Banks. This was in addition to the Board's monetary policy-making function.

securities. By April 2007, a leading subprime mortgage provider, New Century Financial Corp, had filed for bankruptcy (Woll, 2014, p. 86). The turmoil in the US banking system began to challenge the prevailing consensus in favour of financial deregulation. In June 2007, the on-going disruption caused the incumbent Republican-led Treasury to review regulatory institutional arrangements (Lombardi & Moschella, 2017, p. 99) (Bernanke, 2015, p. 435) (Woolley & Ziegler, 2012, p. 40) (Department of the Treasury, 2008, pp. 3-4) (Interview29, 2016) (Interview30, 2016) (Interview32, 2016). The Treasury issued a report in March 2008. This recommended a move towards a simplified regulatory architecture in order to pursue a financial stability objective (Department of the Treasury, 2008) (Bernanke, 2015, pp. 435-6). It also argued, however, that the Fed should lose day-to-day micro prudential supervision (Department of the Treasury, 2008, p. 143) (Bernanke, 2015) (Interview32, 2016) (Interview29, 2016) (Interview30, 2016). Crucially, the Bush Administration never sought to legislate on the back of the report. Nonetheless, this report is important because it revealed the preferences of Treasury officials and alerted to Fed to the challenges it might face to its autonomy.

The 2008 presidential campaign was conducted in the shadow of an unfolding financial crisis. In late March 2008, following the publication of the Republican-led Treasury report on regulatory reform, Democratic Party presidential candidate, Barack Obama, placed supervisory reform at the centre of his campaign (Bernanke, 2015, p. 437) (Carpenter, 2010). Importantly, Obama stated his belief that the Federal Reserve Board should have *"basic supervisory authority"* over those that access its LOLR function (Obama, 2008a) (Bernanke, 2015, p. 437). In doing so Obama signalled a preference for streamlining the existing *"framework of overlapping and competing regulatory agencies"* and empowering the central bank (Obama, 2008a). Obama used the on-going economic downturn to tie the incumbent Republican Administration's policy decisions to the worsening economic situation (Obama,

2008a) (Daily News Staff, 2008). This process of political competition driving preference formation is consistent with the political explanations proposition (Wittman, 1973, p. 495) (Roemer, 2001, p. 7). Obama's policy preference was not derived through a pre-existing partisan belief but rather it was policy preference that best maximised his campaign's utility.

The seminal point of the crisis was the collapse of the Lehman Brothers investment bank, followed by Merrill Lynch, and an $85 billion bailout of AIG (Woll, 2014, p. 87). These events took place two months before the election, and forced a significant change in the rhetoric of the presidential candidates (Scheer, 2010, p. 215). Following the bankruptcy of Lehman Brothers, the financial crisis became the top campaign issue, occupying 43% of campaign coverage (Holcomb, 2013). It remained in this position until the November 2010 election (Holcomb, 2013).[8]

The extent of the collapse sent shockwaves through the political establishment, leading the majority of policymakers to believe that existing banking regulatory architecture required reform (Jacobs & King, 2016, pp. 140-49). Yet the two candidates struck very different tones on the question of institutional reform. As the candidate with no financial legislative record to defend, Obama continued to tie the incumbent Republican Administration's policy mistakes to the worsening economic situation (Obama, 2008a) (Daily News Staff, 2008). By contrast, John McCain was a long-term proponent of financial deregulation sought to defend the incumbent Administration's economic record (Holcomb, 2013) (Shear, 2008). He consequently expressed few preferences on institutional reform, thereby implicitly defending the status quo (The Telegraph, 2008). This response was derided by Obama, who continued to criticise McCain's financial regulation voting record and seeming lack of understanding about the gravity of the crisis (Holcomb, 2013) (Obama, 2008). This is

[8] Once in office the healthcare reform became the number one priority for the Obama Administration. Yet, financial institutional reform remained high on the agenda.

supported by an assessment of media coverage in the period immediately following the Lehman bankruptcy. Between 15-23 September 2008, media coverage of McCain grew much harsher, with only 17% positive compared to 53% negative (Holcomb, 2013).[9]

In November 2008, Obama was elected to the White House and the Democrats increased their control of the House of Representatives and took control of the Senate. During the intense fire-fighting phase of the crisis (2007-early December 2008) the preferences of political actors were relatively imprecisely defined because they were grounded in political competition within an election campaign. The Fed recognised this and sought to gain first-mover advantage. The Fed was quick to anticipate that multiple interests would descend upon institutional reform agenda (Miller, 2010) (Braithwaite & Guerrera, Call for Fed transparency grows louder, 2009) (Paul, 2009a). The literature on the politics of crisis management suggests, following a crisis there is a witch-hunt to find and hold to account those individuals or institutions deemed responsible (Brändström & Kuipers, 2003) (Drennan & McConnell, 2007) (Boin, McConnell, & 't Hart, 2008). The Fed recognised that possessing bank supervisory authority under the status quo institutional arrangements placed it in the firing line as politicians sought to attribute blame for the crisis (Interview34, 2016) (Interview40, 2016) (Interview38, 2016). Therefore, in a pre-emptive move, the Fed created an internal task force in late 2008 to examine institutional reform. Kevin Warsh was appointed to lead this work (Bernanke, 2015, p. 437) (Interview34, 2016) (Interview38, 2016). Warsh had extensive political and financial industry contacts and was therefore well placed to advise the Fed on the path of least resistance in an institutional reform process (Wessel, 2009).

[9] From 8-14 September 2008, 37% of the media narrative focused on McCain was positive in tone, whilst 32% was negative (Holcomb, 2013).

The Warsh-led committee acknowledged the Fed's supervisory failures but blamed these on inadequate capabilities that could be remedied by granting the central bank the authority to determine macroprudential policymaking. Henceforth, the Fed's strategy was to point to a macroprudential gap in the existing architecture in order to defend its existing capabilities (Bernanke, 2008) (Bernanke, 2009f) (Bernanke, 2009c). In turn, the Fed believed this would allow it to safeguard its existing authority in future institutional reform negotiations and prevent the central bank from becoming subordinate to other regulatory bureaux that might lay claim to a macroprudential role.

The process of the Fed's conversion to the macroprudential cause significantly weakens the epistemic community explanation. Senior US regulatory officials had marginalised the macroprudential policy epistemic community that had advocated for macroprudential policy decades earlier (Baker, 2013) (Balzil and Schiessl, 2009). It was only once institutional reform became inevitable, that there was a growing chorus of converts to the macroprudential cause, including the Fed (Bernanke, The Public Policy Case for Role for the Federal Reserve in Bank Supervision and Regulation, 2010f) (Bernanke, 2010e).

Thus far the process points towards a preference formation grounded in electoral interests and bureaucratic competition. First, by tying candidate McCain to the economic policies of the incumbent Republican Administration, the Obama campaign was able to advocate broad ideas for institutional reform, in effect calling for a symbolic break with the regulatory arrangements of the past. Second, the Fed recognised that intense debate on institutional reform and its role in the regulatory architecture was imminent, and set in place a strategy to protect its existing autonomy.

5.4 Multi-Layered Politics of Central Bank Reform: Establishing players and pay-offs (January 2009)

The ACI framework suggests the institutional constraints serve as an exogenous source of change, when government principals themselves change. Despite this significant political change, the outcome of US elections had a limited impact on the prospects of institutional reform due to political institutional constraints. The results certainly increased the likelihood of intuitional reform being placed on the legislative agenda, but due to the institutional constraints (a high number of checks and balances and party factionalism), this alone did not guarantee a move away from the status quo arrangements. For example, a change in government did not resolve fundamental questions about what form institutional reform should take, in respect of the structure and the terms of delegation of new prudential powers. In particular, institutional choices about the location of new macroprudential oversight, as well as the role and powers of the Fed and other regulatory bureaux, were still to be resolved.

The new Administration took office in January 2009. It wasted little time in developing plans to strengthen the Federal Reserve. In order to forestall challenges to the Fed's capabilities from House and Senate politicians, the Administration worked closely with the Federal Reserve to shape the institutional reform agenda (Miller, 2010) (Interview30, 2016) (Interview31, 2016) (Interview38, 2016).

Fed officials were seconded to the Treasury to draft the Administration's institutional reforms (Bernanke, 2015, p. 439) (Geithner, 2014, p. 398) (Interview30, 2016) (Interview31, 2016) (Interview38, 2016) (Interview32, 2016) (Interview40, 2016). (Interview34, 2016). The outcome of this collaboration envisaged the Fed being granted sweeping macroprudential capabilities to monitor and deal with systemic risk; as well as consolidation of micro

supervision[10] under the Fed's authority (Guha and Braithewaite 2009) (Interview30, 2016) (Interview31, Interview with Ernest Tedeschi (senior adviser Treasury Dept), 2016) (Interview32, 2016) (Interview39, 2016). To increase the likelihood of Congressional support, the Administration also advocated removing the Fed's consumer protection role by creating a new and powerful Consumer Financial Protection Bureau (Interview30, 2016) (Interview31, 2016) (Interview32, 2016) (Interview39, 2016). This focus on expanding the remit of the central bank was a consequence of two factors. First, Fed involvement in the drafting process. Second, Secretary Geithner, the highest-ranking Treasury decision-maker, was appointed directly from the Fed. Geithner had a long-held preference for expanding the remit of the central bank (Interview30, 2016) (Interview31, 2016) (Interview38, 2016).

President Obama was determined to secure mass Congressional support for institutional reform to ensure an enduring legacy. As a result, senior Congressional leaders were effectively emboldened by important veto powers over the reform process. Both the Treasury and Fed feared that Congress lacked the technical expertise to lead the process and decided that the best way to protect the Fed's autonomy, and the Administration's vision of reform, was to control the optics of institutional reform options as tightly as possible (Geithner, 2014, p. 398) (Interview30, 2016) (Interview29, 2016) (Interview31, 2016) (Interview32, 2016) (Interview37, 2016). This meant producing a White Paper to set a specific legislative agenda that widened the scope for institutional reform by moving actors' preferences away from the status quo.

Simultaneously, the new Congress wasted little time in exerting its influence by holding to account those individuals and institutions deemed responsible for the crisis (Brändström &

[10] The new administration proposed consolidating the OCC, FDIC and OTS into a single national regulator for depository institutions, and combining the CFTC and SEC under the Fed's authority.

Kuipers, 2003) (Drennan & McConnell, 2007) (Boin, McConnell, & 't Hart, 2008). On 20 May 2009 the newly elected Congress launched the bipartisan Financial Crisis Inquiry Commission. This is significant because it preceded the formal institutional reform negotiations. The Commission's wide-ranging remit saw it investigate the causes of the crisis, as well as examining the regulatory response to the crisis (Wall Street Journal Staff, 2009).

The Fed bore the brunt of the blame in the US, as it had predicted. This became problematic for the Administration's preference for institutional reform. Opinion within Congress became increasingly hostile towards the Fed. Whilst the Commission's final report criticised all bureaux within the byzantine system of financial regulation, the Fed was singled out for the heaviest criticism (Goodhart, 2014, pp. 283-4) (Cooley, Schoenholtz, Smith, Sylla, & Wachtel, 2011, p. 52) (Peirce & Green, 2013, p. 1) (Jacobs & King, 2016) (Johnson C. A., 2011, p. 300). The final report concluded that the Fed was responsible for a failure to mandate better standards of mortgage underwriting, as well as inappropriate supervision of major firms (Financial Crisis Inquiry Commission, 2011, pp. xvii-xviii) (BBC, 2011). The financial crisis resulted in the majority of political opinion coalescing around the need for more oversight of the central bank (Miller, 2010) (Braithwaite & Guerrera, 2009) (Paul, 2009a) (Johnson C. A., 2011, p. 300) (Jacobs & King, 2016, p. 143). As an indicator of congressional dissatisfaction with the Fed, 112 Bills were introduced into Congress in 2009 to try and limit its actions (Goodhart, 2014, p. 285). Although these were politically opportunistic Bills that facilitated grandstanding by individual politicians, they nonetheless represent a meaningful indicator of political interest in limiting the role of the central bank (Goodhart, 2014, p. 285).

The Administration's institutional reform preferences were publically revealed in June 2009. The Administration's preferences represent the 'soft' parameters of the institutional reform.

The Administration and Fed's preferences for institutional reform does not account for the preferences of the independent legislature. These 'soft' parameters are a consequence of political institutional constraints. First, the agreement to pursue a joint-set of preferences is non-binding on the Administration and Fed. Both actors must agree to the reforms in order to present a cohesive approach. Therefore, the institutional reforms agreed at this stage must be in the interests of both the Fed and Administration (Scharpf, 1997, p.7).

The Administration's preferences are a signal from a newly elected Democratic President to a newly elected Democrat-controlled House and Senate. Within the US political constraints, the executive does not always achieve its preferences, given the weak party system in which Congress is not beholden to the President to the same extent as in a Parliamentary system. Within Congress, a sponsor introduces a Bill to the House of Representatives, which is then assigned to a committee for study. If released by the committee, the Bill is voted on, debated, or amended. If the Bill passes by a simple majority (218 of 435 votes), it moves to the Senate, where it is assigned to another committee and, if released, is again debated and voted on. Once more, a simple majority (51 of 100 votes) passes the Bill. Finally, a conference committee made up of House and Senate committee members works out any differences between the House and Senate versions of the Bill, and the resultant Bill returns to the House and Senate for final voting. Once the final votes have taken place, the President has 10 days to sign or veto the Bill.

Though the executive does possess the ability to veto legislation from Congress, this veto can be overridden with a two-thirds Congressional majority. I argue that at a time when the Democratic Party had gained control of all branches of government for the first time in over 8 years, a presidential veto is less likely than a negotiated agreement. Severe conflict between the executive and legislature so soon into the new term would signal to the

electorate that the Party was incapable of governing. Democrats now believed that the electorate would reward ownership of far-reaching regulatory institutional reforms in the wake of the worst crisis in living memory. The result is that the range of possible outcomes is not heavily constrained by the Administration's preferences in the same way the executive's preference would dominate in a parliamentary system. It simply signals the topics that the Administration is concerned with, namely macroprudential and micro prudential reform. At this stage of the process the status quo remains a strong possibility given the considerable political institutional constraints.

To summarise, the Fed and Obama Administration shared a goal of reconfiguring banking regulation through empowering the Fed with both macro and further micro prudential capabilities, whilst stripping the central bank of its consumer protection authority. The political institutional constraints of the US system, however, meant that this preference was not 'locked in'. The architecture agreed between the Administration and the Fed constitutes their ideal preferences; it is important to emphasise that due to the political institutional constraints, the Administration cannot simply impose its preferences upon the legislature by virtue of the Democratic Party majorities across the executive and legislatures. Instead the Administration's preference represents an informal shadow of political hierarchy, from a newly elected Democrat executive to a newly elected Democrat-controlled House and Senate. The range of possible outcomes, however, is not heavily constrained by this set of preferences, as it fundamentally represents an agreement between the executive and central bank to pursue a joint set of preferences, rather than a strict direction to the legislature. The continuation of the status quo remained a strong possibility at this point, given the veto-laden institutional constraints.

5.5 Central Bank Reform Negotiations: the politics of central bank reform

The revelation of the Administration's preference for institutional reform triggered a series of sequential negotiations on the precise shape of institutional reform. The role of the central bank was the focus. Despite a common goal of re-configuring financial regulation post-crisis amongst Democratic Party politicians, reaching agreement on institutional reform proved extremely difficult. It involved a series of protracted negotiations with political, bureaucratic and financial industry actors. The political institutional constraints are such that all actors had the ability to disrupt and veto the institutional reform process.

The remainder of this chapter uses the ACI approach to model these complex negotiations. The negotiations are disaggregated across macroprudential reform; micro-supervisory reform; consumer protection and the central bank independence. Once the institutional reforms are enshrined in legislation, actors cannot unilaterally defect. The rules of the game, defined by the mode of interactions between all actors, can take two forms (Scharpf, 1997). First, under hierarchical direction, Congress (the principal) may simply impose institutional reforms unilaterally. This means that outcomes may be highly suboptimal for other actors as their preferences can effectively be ignored as Congress pursues its own interests. This means that the scope for Congressional-led institutional reform could be far-reaching in theory. If the political explanation holds true this is the expected outcome, as other actors would be locked-out of the process. Under such conditions, I would expect the outcome of the institutional reform to have been decided through a negotiated agreement between the relevant House and Senate Committees, whilst also involving negotiation with the executive to prevent a veto, before being imposed upon other actors in the process, namely the regulatory bureaux and financial industry.

Second, an institutional outcome may be found through negotiated agreement amongst all actors (political, bureaucratic and industry). It follows that the scope for change is much lower under this mode of interaction and that the final outcome cannot be sub-optimal for any influential actor. The most influential actors would effectively wield veto power.

The resolution of these negotiations does not suggest that the process of reconfiguring delegation is a hierarchical one where the political principals can impose institutional reform on subservient actors; rather, it involves a prolonged process of bargaining and negotiation amongst several groups of actors with diverging preferences. Thus, the outcome of US institutional reform is characterised by institutional layering. Despite, the political constraints, diffuse bureaucratic authority; and financial industry lobbying, the perception of the Fed's expertise enabled it to exploit its influence over the legislature and secure more favourable outcomes across the negotiations. This was despite the central bank being deeply unpopular. The following analysis provides evidence for this claim.

5.5.1 Macroprudential Reform

This first disaggregated negotiation concerns the location of macroprudential supervision. It is played out between multiple actors: the Fed, other regulatory bureaux, the Administration, and Congress. The Administration's specific preference was to grant extensive new macroprudential powers to the Fed and to make the central bank a member of the President's Economic Working Group. This group would act as the US macroprudential authority. The Fed considered a small macroprudential council centred on the central bank to be essential to strengthening the US's capacity to respond to crises, and to protect its own lender-of-last-resort function from interference by other regulatory agencies. For the Administration, designating the Fed as the lead macroprudential regulator within an existing institutional structure would strengthen accountability to the executive. Importantly, however, accountability was to be achieved by the Treasury retaining political

control through its chairmanship of the proposed macroprudential Presidential Advisory Group (Appelbaum & Cho, 2009).

Ultimately, the institutional design that emerged saw the creation of a new institution – the multi-agency Financial Stability Oversight Committee (FSOC) – layered on top of the existing architecture (Morrison & Foerster, 2010, p. 4). The creation of the FSOC appears to have been a suboptimal outcome for the Administration and the Fed. Neither actor wanted FSOC to be created (Braithwaite, Democratic senator sees Fed as block to reform, 2009) (Goodhart, 2014, p. 86) (Interview31, 2016) (Interview30, 2016) (Interview29, 2016) (Geithner, 2014, p. 403). The governance structure of FSOC places the Treasury Secretary as chair, while voting members include: Treasury; Fed; OCC; SEC; SCTC; FDIC; FHFA; and CFPB. In addition, an insurance expert may also sit on the Council by appointment of the President and ratification by the Senate (Morrison & Foerster, 2010, p. 4). How was this macroprudential outcome reached?

Given the severity of the crisis, the goal of systemic risk regulation was not controversial (Woolley & Ziegler, 2012, p. 34). It was no longer plausible to argue that market discipline alone would ensure financial stability. Yet, once revealed, the Administration's preference to centralise macroprudential power within the central bank met with resistance on multiple fronts.

First, opposition came from other regulatory agencies. Sheila Bair, chair of the FDIC, led this opposition. Bair insisted that the authority of other regulators should not be subordinate to a Fed-dominated macroprudential council (Jacobs & King, 2016, p. 14) (Braithwaite & Guerrera, 2009) (Ziegler & Woolley, 2016, p. 25) (Bernanke, 2015, p. 442) (Interview38, 2016) (Interview40, 2016). Bair suggested that having the Fed and Treasury exclusively

dictating macroprudential policy would not benefit other regulators. Smaller bureaux would be bound by these actors' decisions. Bair was concerned about the prospect of the Fed being able to take decisions on the resolution of systemically important institutions leaving the FDIC with resolution power over small non-systemic firms (Federal Deposit Insurance Corporation, 2017, p. 175) (Interview40, 2016) (Interview31, 2016) (Interview38, 2016) (Interview30, 2016). This would have represented a significant loss in status for the FDIC, and other bureaux that regulated systemic elements of the financial sector. As a result Bair advocated a counter-proposal – a powerful interagency council to manage systemic risk with its own rule-making capability and an independently appointed chair (Braithwaite, Scholtes, Duyn, & Guerrera, 2009) (Bernanke, 2015, p. 442) (Interview38, 2016) (Interview40, 2016).

Other bureaucratic leaders seeking to safeguard their institutions existing capabilities supported Bair's counter proposal. These bureaux utilised their congressional contacts, crafting a coalition to block the Administration's preference for macroprudential reform. For example, the FDIC had personnel on secondment to the offices of Congressmen and members of the Senate and House financial oversight committees (Interview40, 2016) (Interview38, 2016). These personnel were instructed to brief against the Administration's macroprudential proposal (Interview40, 2016). Similarly, the CFTC exploited the fact that it came under the jurisdiction of the Committee for Agriculture in Congress, reflecting the origins of futures trading in this sector. Because of the status these committees derived from holding financial regulators to account their members jealously guarded the role of the CFTC from any encroachment (Interview30, 2016) (Interview31, 2016) (Interview38, 2016) (Interview39, 2016). Consistent with political explanations the committee membership wished to maximise their media exposure surrounding high profile issues for electoral gain ahead of the November 2010 mid-term elections.

Second, the financial services lobby was concerned over the possible costs of particular macroprudential arrangements. Crucially, however, the factions within financial industry lobby did not oppose the idea of macroprudential oversight, just the Administration's proposed architecture. Large banks that would be the subject of macroprudential policy were concerned that creating an institutional structure around the central bank would reduce the possibility of regulatory arbitrage in the future. Therefore larger banks supported Bair's inter-agency council on the grounds that it would largely preserve the existing arbitrage opportunities (Geithner 2014, p.403). Similarly, smaller firms less directly impacted by macroprudential policy-making also threw their support behind Bair's idea. These smaller firms feared that excluding smaller bureaux from macroprudential regulation would lead to financial policy that locked in the advantage of the biggest banks thereby creating an unlevelled playing field. As a result the financial services lobby was united in opposing the Administration's preference. The financial services lobby had successfully captured the regulatory oversight committees and other politicians through contributing campaign donations to individual politicians and local investment (Geithner, 2014, pp. 400-01) (Guha & Braithwaite, 2009) (Interview30, 2016) (Interview31, 2016) (Interview38, 2016) (Interview34, 2016). This allowed them an effective opportunity to block the Administration's preference for macroprudential reform by supplying information directly to its congressional sphere of influence. The lobbying of the untied financial industry reduced the number of votes the Administration could rely on to pass its version of macroprudential institutional reform. This process is consistent with the financial industry-lobbying proposition. In the absence of industry opposition it is not necessarily the case that the Administration would have achieved its macroprudential preference. The bureaucratic resistance would have remained a significant obstacle. However, the absence of industry opposition would have removed a significant veto point.

Finally, the Administration's preferences also encountered political opposition in the Senate. Chris Dodd published a counter proposal, recommending the creation of a new institution solely responsible for financial stability: the Agency for Financial Stability (AFS). Dodd believed this was the most effective way of creating a symbolic break with the architecture of the past and therefore the clearest way of locking-in electoral gains in 2010 mid-term elections (Interview30, 2016) (Interview31, 2016) (Interview32, 2016). Dodd proposed that an independent presidential nominee lead this agency (FInancial Times, 2009). This was diametrically opposed to the preferences of all bureaucratic and industry actors, as well as the Administration. Dodd argued during a Committee hearing that:

> *'Giving the Fed more responsibility...is like a parent giving his son a bigger, faster car right after he crashed the family station wagon'* during a Committee hearing (Senate Banking, Housing, and Urban Affairs Committee , 2009, p. 2).

Dodd's Bill proposed that the new Agency should have responsibility for identifying, monitoring and addressing systemic risks; the authority to break up large institutions if they threatened financial stability; and the power to write rules on capital, liquidity and leverage (Crowley, Heiman, Shah Page, Holman, & Clark, 2009) (Masters, Braithwaite, & O'Connor, 2009).

The bureaucratic politics and industry interference was not well received by the Administration. Treasury Secretary Geithner responded that: *'You can't convene a committee to put out a fire'* (Geithner, 2014, p. 403). The alternative design was at odds with the preferences of the Administration because it did not locate macroprudential oversight in the central bank and risked dispersing accountability across multiple institutions (Braithwaite, Democratic senator sees Fed as block to reform, 2009) (Goodhart, 2014, p. 86) (Interview31, 2016) (Interview30, 2016) (Interview29, 2016).

Given the Fed's perceived failure in preventing the crisis, many politicians in Congress shared concerns about centralising macroprudential authority within the central bank. The process reveals that this political opposition also came from senior Democrats; namely Chris Dodd and Barney Frank, Chairman of the House Financial Services Committee (Bernanke, The Courage To Act, 2015, p. 443). Frank informed the Administration that centralising macroprudential regulation within the Fed was a '*great idea but not achievable in the United States'* (Interview32, 2016) (Bernanke, 2015, p. 443). Frank's judgement was that ultimately he would have to abandon the pursuit of the Administration's preference in favour of Bair's multi-agency council to get macroprudential institutional reform passed. His misgivings were cemented when bonuses were paid out to AIG executives following its nationalisation (Andrews & Baker, A.I.G. Planning Huge Bonuses After $170 Billion Bailout, 2009) (Interview32, 2016). The Fed had direct oversight of the firm but could not stop the pay outs. This increased public anger with the Fed. Frank believed that bureaucratic, industry and public opposition was too much to overcome (Lombardi & Moschella, 2017). He summarised the change in political tone during a House debate, stating that:

> '…there was a great deal of interest in how the Federal Reserve has used that authority, how much money has been deployed, what are the criteria, to what extent are taxpayers at of risk for losing money here…Going forward though, it does not seem to me healthy in our democracy for the amount of power that is lodged in the Federal Reserve with very few restrictions to continue' (Lombardi & Moschella, 2017, p. 102).

The table below summarise the positions of the actors involved in macroprudential reform. In doing so it highlights that layering an interagency macroprudential council on top of the existing regulatory architecture was the path of least resistance in order to successfully negotiate a macroprudential institutional reform outcome.

Table 8: US actor preferences on macroprudential policy

	Agency for Financial Stability	Inter-agency council	Federal Reserve-led Presidential working group
Barney Frank	☐	☐	☐
Chris Dodd	☐	☐	☐
Financial Industry	☐	☐	☐
Bureaux	☐	☐	☐
Federal Reserve	☐	☐	☐
Administration	☐	☐	☐

On the advice of Barney Frank, the Administration was resigned to accepting an inter-agency macroprudential council (Interview32, 2016) (Interview40, 2016) (Interview30, 2016) (Interview31, 2016). This decision was a direct consequence of the bureaucratic, industry and political opposition encountered.

As a result of both counter proposals, the Fed objective became one of ensuring a dominant role rather than exclusive role in macroprudential policy-making, thereby avoiding it becoming subservient to other bureaux. Above all the Fed feared a loss of autonomy. However, the diffuse bureaucratic authority restricted the ability of the central bank to negotiate reforms without significant compromise. Evidence for this claim is provided through examples of interactions between the Fed and Congress.

First, in Spring 2009, the Fed openly called for macroprudential empowerment in a series of high-profile speeches (Bernanke, 2009c) (Goodhart, 2014, p. 285). Bernanke pointed to a

gap in the existing architecture as a result of the Warsh committee's work. He suggested that the Fed's hands had been tied during the pre-crisis years in respect of macroprudential tools, and that it therefore required additional authority:

> 'A lack of statutory authority carried with it a lack of information… Moreover, the lack of pre-existing reporting and supervisory relationships hindered systematic gathering of information that might have helped in the early days of the crisis.' (Bernanke, 2010d, p. 3).

Second, Fed officials made reference to international cases where central banks were empowered with macroprudential authority (Masters, Braithwaite, & O'Connor, 2009). Internationally macroprudential reforms were being considered not simply as complementary, but intertwined, with monetary policy. For example, a decision related to financial stability can impact upon a future decision on monetary policy. The Fed declared ostracising it from a leading role would *'seriously impair the prospects for economic and financial stability in the United States'* (Bernanke, 2009e). Bernanke implored Congress to '*preserve, not degrade, the institution's ability to foster financial stability and to promote economic recovery without inflation'* (Bernanke, 2009e).

Finally, Fed officials emphasised the importance of the Fed's expertise to the successful execution of macroprudential policy, arguing that only the central bank possessed the capabilities required (Bernanke, 2009c) (Interview31, 2016) (Interview30, 2016) (Interview40, 2016) (Interview39, 2016):

> *"…addressing macroprudential risks require a deep expertise in the areas of macroeconomic forecasting, financial markets, and payments systems. As a result of its central banking responsibilities, the Federal Reserve possesses expertise in those*

> *areas that is unmatched in government and that would be difficult and costly for another agency to replicate"* (Bernanke, 2009c).

Bernanke went on to assert that the Fed's *"economists, financial market specialists and other experts"* had used their *"combination of expertise, a unique strength of the Fed" to* bring credibility and clarity *to the "stress tests" of the banking system* (Bernanke, 2009e). Fed officials suggested it was responsible for restoring "*public confidence in the banking system"* post crisis (Bernanke, 2009e).

Despite the Fed's campaign, political reservations about empowering the Fed still remained in October 2009 (Lombardi & Moschella, 2017, p. 102). One member of the Senate summed up the political mood by stating that:

> *"I am not alone in my concerns about the Fed as a systemic regulator. There seems to be a universal distaste for the Fed in such a role on the Senate Banking Committee. Such a political reality would seem to make it less likely that the House would confer such new powers on the Fed either."* (House of Representatives, 2009a).

The impasse was eventually broken by a proposal from the House for a much weaker interagency council called the Financial Stability Oversight Committee (FSOC) (Cho & Dennis, 2010). This change in position came about because it was the path of least resistance due to the bureaucratic and industry opposition to both the Administration and Dodd proposals. House Democrats rallied behind the compromise proposal. They had an additional incentive to reach a compromise on institutional reform in advance of the November 2010 mid-term elections – when all 435 House seats would be contested. In comparison, 37 of 100 Senate seats would be contested. Consistent with the political explanations proposition, Democrat

politicians were eager to claim electoral credit for addressing the causes of the financial crisis within the window of opportunity presented (Cho & Dennis, 2010) (Masters et al., 2009) (Interview30, 2016) (Interview31, 2016) (Interview32, 2016). Chaired by the Treasury Secretary, the FSOC would bring together the existing regulatory agencies to provide aggregate oversight, identify emerging systemic risks, and designate individual firms as systemically important. This compromise would guarantee roles for each bureau in the new macroprudential architecture.

Though the Administration remained critical of the compromise because it risked dispersing macroprudential responsibility across multiple institutions, its opposition gradually fell away as it became clear that the compromise had support from the Democrat politicians, financial industry, and bureaucratic actors (Geithner 2014, p. 403) (Woolley & Ziegler, 2012). (Interview31, 2016) (Interview32, 2016) (Interview34, 2016). A senior Treasury official stated:

> *"We had to make a choice about what we wanted to do and what was politically possible. The choice was what we thought would lead to the biggest impact in terms of reducing risk in the financial system"* (Interview39, 2016).

Crucially, however, the compromise did not propose that FSOC should have any macroprudential rule-making authority (Bernanke, 2015, p. 443). The Fed argument about central bank expertise and bandwidth proved highly effective in preventing its monetary policy-making function becoming subordinate to the decisions of an inter-agency council. Instead, FSOC would be an information-sharing forum. It would facilitate the Fed's access to prudential analysis from other agencies regarding systemically important firms (Goodhart,

2014, p. 286) (Interview30, 2016) (Interview31, 2016) (Interview40, 2016).[11] Second, FSOC would provide aggregate oversight, identify emerging risks and designate individual institutions as systemically important. This sign-off process would delegate macroprudential regulation to the Fed, including the ability to impose heightened prudential standards related to leverage, liquidity, and resolution, as well as the authority to compel banks to sell off assets or suspend activities if they threatened financial stability (Lombardi & Moschella, 2017, p. 102) (Bernanke, 2010f, p. 1) (Interview38, 2016) (Interview40, 2016) (Interview30, 2016) (Interview31, 2016) (Interview32, 2016).

This move by Frank was a compromise required to gain the support of the central bank, whose most significant concern was losing policy-making autonomy. These policy details reflect concerns amongst politicians that only the central bank really possessed the expertise and bandwidth to discharge macroprudential policy. This was the essence of the advocacy from senior Fed officials and it was something that other bureaux found difficult to counter. This reliance on technical expertise, supported by the macroprudential reforms being considered internationally, allowed the Fed to gain aspects of macroprudential authority that it believed to be most important to protect its monetary policy autonomy. Staff in congressional offices subject to Fed lobbying confirmed that there was a genuine belief amongst politicians that alternative bureaux could not manage macroprudential responsibility as effectively as the central bank:

> *"It came down to the fact that you can't have these systemically important firms and you have to have them designated and who is going to do this higher macroprudential regulation? The only place that can really to that is the Fed."* (Interview32, 2016) .

[11] At the time of its collapse an investment firm such as Lehman Brothers was supervised by the FCC. The Fed shared supervisory responsibility for other systemically risky banks on a consolidated basis with the OCC and FDIC.

When President Obama signed the DF Act into law on 21 July 2010, the macroprudential solution put in place mirrored the compromise brokered by Barney Frank. It represented a compromise that all actors could live with. It provided certainty of status for all bureaucratic actors, whilst also satisfying the financial industry lobby. In doing so it allowed Democrat politicians to vote in favour of macroprudential regulation safe in the knowledge that they could continue to rely on industry support, whilst simultaneously claiming electoral credit for having resolved the post-crisis regulatory deficit. The Administration was satisfied that it gained control of the FSOC through chairmanship, rather than Congress appointing an independent chair. This provided a formal mechanism for managing policy conflicts by giving a deciding vote to the Treasury. In this sense the macroprudential negotiation provides a somewhat unsatisfactory conclusion for the majority of the theoretical explanations being tested. Though the process does weaken the epistemic community explanation. It points towards domestic factors as explaining the outcome of the macroprudential negotiation.

In summary, the Administration's plan to centralise macroprudential policy making in the Fed was blocked by Congress, bolstered by the opposition of existing regulatory agencies and financial services, whose positions were threatened by proposed changes. Although political, bureaucratic and industry resistance was sufficient to defend the pre-existing institutions, it could not, however, prevent key Congressional actors from agreeing to create new, overlapping structures. In this overlapping structure, the Fed obtained a preeminent position, with operational authority for reducing system-wide risk, but its responsibilities were submerged within a broader set of voting members (Woolley & Ziegler, 2012, p. 15). Hence, the solution that emerged (FSOC) represented a form of institutional layering,

overlaying the existing institutional architecture with a new body to coordinate macroprudential oversight across different agencies.

5.5.2 Micro Prudential Reform

A second disaggregated negotiation on micro supervision occurred simultaneously. The negotiation was played out between the Federal Reserve, other regulatory bureaux, the financial industry lobby, and politicians. The Administration's preferences, if enacted, would have simplified the micro supervisory landscape, thereby strengthening the Fed's micro prudential reach by consolidating prudential supervision within the central bank.

During the election campaign, Obama signalled that consolidation of financial regulation was a main institutional reform priority. The Obama Administration argued that fragmentation encouraged industry venue shopping and regulatory arbitrage. Based on their experience during the crisis, the Fed and the Treasury agreed that merging agencies was essential to reduce the risk of supervisory failures and to enhance the government's capacity to act decisively in a crisis (Interview30, 2016) (Interview40, 2016) (Interview31, 2016). The new Administration proposed consolidating the OCC, FDIC and OTS into a single national regulator for depository institutions, and combining the CFTC and SEC under the Fed's authority. The Administration's proposal on micro prudential regulation soon encountered significant opposition.

First, resistance to regulatory consolidation came from bureaucratic actors. As with macroprudential reform, the head of FDIC, Sheila Bair, was relentless in defending bureaucratic interests (Braithwaite, Scholtes, Duyn, & Guerrera, 2009) (Interview40, 2016) (Bair, 2012, p. 187) (Bernanke, 2015, pp. 442-3). Once again the CFTC successfully exploited the fact that it came under the jurisdiction of the Committee for Agriculture in Congress. As in the macroprudential negotiation, the significant campaign contributions members of the

Committee received from the financial industry, as well as media exposure, meant its membership jealously guarded the role of the CFTC from any encroachment. Individual politicians were unwilling to forgo this funding or the limelight of oversight committee hearings. This bureaucratic opposition was sufficient to reduce significantly the prospect of success for the competing consolidation proposals put forward by both the Administration and the Senator Dodd. This environment of diffuse bureaucratic authority resulted in the Fed being unable to convince congressional principals to pursue a regulatory consolidation agenda. In an environment of more concentred bureaucratic authority, the congressional backing for individual bureaux would not have been as widely spread. Thus it is possible that the under conditions of more concentrated bureaucratic authority support may have gathered around a proposal to empower one regulatory bureaux over another. The process of bureaucratic resistance blocking consolidation because each reform option threatened the turf of at least one bureaucracy is consistent with the bureaucratic politics proposition.

The prospect of consolidation also triggered a wave of financial industry lobbyists. The financial industry aggressively opposed regulatory consolidation, arguing that it would cause years of unnecessary disruption (Appelbaum and Dennis, 2009). The financial industry was motivated by its preference to maintain the status quo of regulatory ‘competition’ between agencies for reasons of venue shopping and arbitrage (Appelbaum and Dennis, 2009). A system of diffuse bureaucratic authority aided this objective. As with macroprudential reform, the factional industry was untied in its preference on consolidation. It was, therefore, successfully able to exert influence over politicians once more. Whilst it is likely that firms provided campaign funding to individual politicians that would be difficult for them to replace with other sources, evidence suggests that campaign donations was not the primary source of industry political influence. Rather, if was the fact that community banks were responsible for good economic outcomes within congressional districts (Jacobs & King,

2016) (Interview30, 2016) (Interview31, 2016) (Interview38, 2016). With mid-term elections looming, members of Congress did not wish to relinquish high-profile positions holding regulatory agencies to account, possible campaign funds, or be held responsible for harming economic output in their districts. Without the votes to enforce consolidation, it was impossible to achieve the Administration or Dodd's preferences. United industry opposition, controlling the flow of information to politicians, was a necessary condition to defeat the proposals for regulatory consolidation. In the absence of a united financial industry lobbying a significant veto would have been removed from the process and politicians would have been free to pursue more radical reform. It is plausible that more politicians, irrespective of partisanship, would have been willing to back regulatory consolidation in the absence of any industry lobbying. Thus the process strengthens the financial industry lobbying proposition. When industry opposition was combined with bureaucratic resistance the pre-crisis institutional architecture of regulatory agencies survived largely intact.[12]

Nevertheless, the threat hanging over the Fed's future micro prudential role remained. Whilst wholesale regulatory consolidation was off the table, the micro prudential role of the central bank remained a contested issue. The Dodd proposal sought to diminish the supervisory authority of the Fed greatly and to place it in a subordinate role to FRIA or spilt its micro supervisory authority amongst the existing regulators (Masters, Braithwaite, & O'Connor, 2009). The Administration's proposal, on the other hand, was to empower the Fed as the micro prudential regulator of all systemically risky firms, including non-bank holding companies.

To make its case for micro prudential empowerment to a sceptical Congress, the Fed began a campaign of intensive political lobbying. This began as early as March 2009 (Bernanke,

[12] Only the Office of Thrift Supervision was abolished and folded into the OCC.

2009c). Its strategy was to first highlight how the Fed had learnt from pre-crisis errors to improve its existing supervisory practices. Second, the Fed linked micro supervision to financial stability and its core objectives as a central bank (monetary policy and LOLR) (Interview29, 2016) (Interview30, 2016) (Interview31, 2016) (Bernanke, 2009d) (Bernanke, 2010b) (Bernanke, 2010f). There is no evidence to suggest that other bureaux proactively sought to take on the Fed's supervisory authority. This finding is rational given that micro prudential supervision is largely seen a 'no win' issue. There will always be a micro prudential failure; the regulatory agency will be apportioned blame; and, therefore, suffer from reputational damaged or even abolition.

The Fed responded robustly to this latest threat, as evidenced through examples of interactions between the Fed and Congressional actors. First, Fed officials emphasised that in the event of a crisis, it was vital to have instant access to the expertise and information held by firm supervisors (Bernanke 2010, p. 7) (Bernanke, 2010f) (Bernanke, 2009d) (Bernanke, 2010). Restricting access to supervisory data would negatively impact monetary policy decision-making. For example, the Fed cited how supervisory information on aggregate loan losses on bank balance sheets during the early stages of the crisis led the Fed to ease monetary policy *"more aggressively"* than it would otherwise have done (Bernanke 2010, p.7) (Interview39, 2016). Relying on other bureaux for information on specific firms is slower and more cumbersome than obtaining it directly from firms (Bernanke, 2010f, p. 2) (Bernanke, 2010f). In support of its position, the Fed explicitly cited the blurred division of labour and poor communication between the Bank of England and FSA. The Fed pointed to evidence suggesting the UK pre-crisis regulatory arrangements, which divorced the central bank from supervision, amplified the magnitude of the crisis (Bernanke, 2010f) (Bernanke, 2010e) (Interview39, 2016) (Interview29, 2016) (Interview30, 2016) (Interview31, 2016) (Interview40, 2016) (Interview38, 2016).

Second, the Fed raised the issue of its supervision being more robust than any alternative bureau was capable of providing. In support of this, the Fed often cited the case of AIG to politicians. AIG was regulated by the OFT prior to the crisis, rather than the central bank (Bernanke, 2010f, pp. 7-8) (Interview38, 2016) (Interview39, 2016). In a letter to the Senate Banking Committee, Bernanke wrote:

> *"Many of the large, complex, and interconnected financial firms whose collapse contributed importantly to the financial crisis avoided the more stringent consolidated supervision that is imposed on bank holding companies by the Federal Reserve. These firms--which included AIG, Washington Mutual, Countrywide, Bear Stearns, and Lehman Brothers – were instead subject to consolidated supervision under statutory or regulatory schemes that were far less comprehensive"* (Bernanke, 2010f, p. 2).

By using the voice of its internationally well-respected Chair, the Fed's arguments were granted legitimacy amongst wider market participants. In turn, this made it more difficult for Congress to credibly revoke Fed micro supervisory authority. Doing so would have pitted politicians against an internationally recognised expert in financial regulation. The technical arguments put forward by the central bank along with the political desire for institutional reform before 2010 mid-term elections, led the Fed Board and the Senate Banking Committee towards a negotiated agreement in March 2010. Without the defensive technical arguments put forward by the Fed it is reasonable to assume that politicians would have sought to reduce the scope of the Fed's micro-supervisory authority for electoral gain. The Fed's intervention in the process cast doubt on the wisdom of isolating the central bank from micro prudential supervision.

The negotiated agreement proposed limiting the Fed's micro supervisory role to systemically important holding companies with assets greater than $50 billion (of which there were approximately 35). Importantly, this compromise would include all large non-bank financial institutions, such as AIG (Felsenthal, Bernanke defends Fed small bank supervision role, 2010). As a consequence, supervision of more than 5,000 smaller community banks would be removed from the Reserve System and split amongst the FDIC and OCC (Puzzanghera, 2010) (Felsenthal, 2010). Fed Board members initially concluded that this was a necessary sacrifice in order to protect its LOLR facility (Interview40, 2016) (Interview34, 2016). One senior Fed official involved in the discussions recalled:

> *"There were mixed views amongst the Fed board members…the trade-off was we would lose the community banks. There was a lot of discussion that the Fed didn't need to do that [community bank supervision] and from a systemic perspective"* (Interview40, 2016).

Neither the Fed nor the Senate, however, anticipated the strong negative response from the Reserve Banks. For most Reserve Banks, community bank supervision was viewed as a high-status role. Reserve Banks traditionally enjoyed close relations with these firms.[13] The factionalism within the Federal Reserve created an unexpected veto point. Reserve Bank presidents reacted angrily to the negotiated agreement and set out to veto the compromise (Hoening, 2009) (Puzzanghera, 2010) (Interview39, 2016) (Interview30, 2016) (Interview31, 2016) (Interview40, 2016). Most vocal were the Reserve Banks of Kansas, Cleveland, Richmond, and Minneapolis, which put forward a series of technical arguments linking community bank supervision to better monetary and financial stability policy decision-making. They maintained that the data they collected enhanced the Fed's monetary policy and discounted window decision-making processes (Kocherlakota, 2010) (Federal Reserve

[13] Each Reserve Bank has its own its own board of directors appointed in consultation with industry.

Bank Of Philadelphia, 2009, pp. 6-16). Bernanke's own arguments for the Fed maintaining a role in micro supervision were recited back to the Board and politicians by the Reserve Banks. In addition, Reserve Banks argued that restricting the Fed's supervisory role to the largest banks would lead to an unlevelled playing field in favour of the largest financial institutions and centralise decision-making within the Fed Board (Puzzanghera, 2010) (Interview11, 2016) (Interview30, 2016) (Interview31, 2016) (Interview40, 2016).

The compromise on community bank supervision was also received badly by community banks themselves. Community banks hold influence over the politicians in their districts. First community banks can provide campaign funds to politicians. Second, they were in a relatively strong position because community banks were not deemed culpable for the crisis. Third there is at least one community bank in each congressional district (The Economist, 2019). As a result, they are responsible for a significant number of jobs and economic prosperity within politicians' constituencies. For example, within congressional districts a community bank's small business lending can account or 40% of business loans (The Economist, 2019). Ultimately it is politically beneficial for politicians to enact policy favourable to community banks. This, in turn, led to the legislative route being vetoed by politicians conscious of retaining their seats in November 2010 mid-term elections. Allowing community banks to thrive presents an obvious local campaign issue.

The coalition of Reserve Banks and community banks blocked the micro prudential compromise. Collectively they were able to reduce the appetite for the compromise amongst politicians. The involvement of Reserve Banks and community banks as veto players strengthens both the financial industry lobbying and bureaucratic politics propositions. For individual politicians the electoral cost of opposing the community bank lobby outweighed the potential gains in the form of increased campaign funding or tangible

examples of enacting policies that benefited their constituents. Thus to oppose community banks is often deemed politically impossible – micro prudential reform proved to be one such case.

With the route towards a compromise blocked, the Fed Board was forced to alter its strategic position (Bernanke, 2015, pp. 459-461) (Felsenthal, 2010a). It now argued for retaining community bank supervision as well as enhanced supervisory powers over non-bank institutions (Bernanke, 2010c) (Felsenthal, 2010) (Interview34, 2016) (Interview38, 2016) (Interview40, 2016) (Bernanke, 2010b, p. 446). In the absence of bureaucratic and industry interference, the Fed and Congress would have formally agreed the micro prudential compromise. The Fed and politicians would have had no incentive to reject the compromise; therefore preferences would not have shifted.

In the face of significant industry and bureaucratic opposition, Dodd was forced to back down and acquiesce to the Fed's preference of adding all systemically risky firms to its supervisory remit, without compromising its existing micro supervisory responsibilities. The forced change in the Fed's strategy inadvertently changed the environment to one of concentrated bureaucratic power. This allowed the Fed, by chance, a route to negotiate a new compromise agreement that satisfied its original preference. The interference of the community bank lobby was critical in moving the point of compromise even closer to the Fed's preference – no loss of status quo micro prudential authority. This outcome was eventually enshrined in the Dodd-Frank legislation. A Fed official stated:

> *"We won the vote...ultimately there just wasn't enough interest in up-ending the system in this way"* (Interview40, 2016).

The process reveals that opposition to regulatory consolidation in the form of bureaucratic politics, financial industry influence, and political resistance precipitated the causal chain that led to the defeat of the radical proposals for micro prudential institutional reform. As a result, the pre-crisis supervisory architecture survived largely intact; only the Office for Thrift Regulation was abolished. Once again, Congress effectively vetoed the Obama Administration's plans to significantly strengthen the supervisory powers of the Fed, with the support of the other regulatory agencies and the financial industry. Unlike macroprudential regulation, however, it was not possible to circumvent political, bureaucratic, and financial industry opposition by creating new institutional structures. The absence of significant reform in this instance reflected the fact that the debate about micro prudential reform concerned the location of existing supervisory powers, not the creation or coordination of new policy tools or instruments. As a result, all reform proposals threatened the bureaucratic 'turf' of at least one existing agency, which in turn triggered interventions from other actors.

5.5.3 Consumer Protection Reform

The consumer protection negotiation is integral to understanding the macroprudential and micro supervisory institutional reform. Democrat politicians may not have been unified in their vote for the institutional reform package unless the reform package guaranteed the creation of a new powerful consumer protection body. Therefore, failure to agree consumer protection reform would have significantly increased the likelihood of the institutional reforms collapsing. This section explains the importance of the consumer protection to the macro and micro prudential institutional outcomes.

Secretary Geithner believed that in order to secure congressional agreement for the whole institutional reform package, lawmakers would need to punish the Fed in a high-profile

manner (Bernanke, 2015) (Interview31, 2016) (Interview30, 2016). A Treasury official recalled:

> *"Tim's [Treasury Secretary's] view was, that you couldn't keep giving things to the Fed. You had to take some things away – and this was a pretty harmless thing to take away"* (Interview31, 2016).

Senior Democrats agreed with this strategic approach. Under the status quo the Fed was the rule-maker for consumer regulation, though some agencies conducted consumer protection supervision according to the Fed's rules. The loss of consumer protection represented an easy way of achieving the optics of punishing the central bank without harming the Fed's core capabilities. Including this negotiation as part of the institutional reforms greatly increased the possibility of overcoming the factional nature of party politics and achieving the post-crisis institutional reform in the round. Democrats were united in their desire for consumer protection reform.

The Fed itself was keen to hive-off this capability. Bernanke, when presented with the Administration's proposal, confirmed that relinquishing consumer protection responsibility was acceptable to the central bank if it was necessary to gain macro and enhanced micro prudential authority. The Fed concluded that loss of consumer protection would not hamper the discharge of its core objectives – monetary, macro, or micro prudential supervision. In fact, delegating an overtly political task to a new agency allowed the Fed to increase its policy discretion over its most desirable functions, better protecting its autonomy (DePillis, 2014) (Interview34, 2016) (Interview40, 2016) (Interview38, 2016) (Bernanke, 2015, pp. 445-6) (Interview29, 2016) (Interview30, 2016).

Elizabeth Warren, an academic, was the highest-profile advocate of an independent powerful consumer protection agency (Bernanke, 2015, p. 445) (Warren, 2007) (Bar-Gill & Warren, 2008) (Woolley & Ziegler, 2012, p. 46) (DePillis, 2014). In 2007, Warren published a paper in the journal 'Democracy' arguing for strong independent consumer financial protection (Soucy, 2013, p. 693) (Woolley & Ziegler, 2012, p. 42). Whilst the essay was well received in academic circles, it was not until after the crisis that it gained significant traction amongst Congressional Democrats and President Obama (Carpenter, 2010, p. 827) (Woolley & Ziegler, 2012). The Administration and Democrats believed that the potential electoral gains from creating the first financial consumer protection agency would be significant in the 2010 mid-term elections.

Warren met with Larry Summers, the President's senior economic adviser, at a Washington DC restaurant in April 2009 (Woolley & Ziegler, 2012, p. 46) (Skeel & Cohan, 2010, p. 51) (Palletta, 2010). The result was that the financial reform White Paper released by the Administration included a new consumer financial protection agency modelled on Warren's idea (Congressional Oversight Panel, 2009, p. 30). The idea quickly gained support amongst Democrats in the House and Senate, as their major criticism of the Fed had been over its inability to discharge consumer protection powers effectively (Goodhart, 2014). In July 2009, Representative Barney Frank included a consumer protection agency in his House institutional reform Bill (Soucy, 2013, p. 693).

Due to Warren's promotion of consumer protection, the Administration's blueprint stated that the new agency would be led by a multi-member commission and funded through the congressional appropriations process (House of Representatives, 2009, p. 17). Yet in the final institutional reform voted on by the House of Representatives in December of 2009, the new agency was designed to be free from the Congressional appropriations process.

Instead the CFPB would receive 10% of the Fed's budget each year. Crucially, the Fed was also designed to be independent of Congress, and therefore is self-funded. Furthermore, by April 2010, when Dodd introduced the institutional reform package in the Senate, the agency had been changed from a standalone agency to a bureau of the Fed, with a single director (Congress, 2010). The reasons for these changes in the architecture of consumer protection are integral to understanding the macroprudential and micro supervisory institutional reform. Democrat politicians may not have been unified in their vote for the institutional reform package unless it guaranteed the creation of a new powerful consumer protection body.

The Administration's rationale for stripping the central bank of its consumer protection responsibility followed the logic of the political explanation. The arguments were two-fold: first, no agency that was solely focused on consumers' needs had ever existed (Interview37, 2016) (Interview35, 2016). The creation of this new institution allowed the Democrats to highlight a clear break with the past. Democrat candidates were united in campaigning for better consumer protection; the agency was central to the Obama Administration's reforms and important to the re-election campaigns of the Democratic Party majorities in Congress. Second, the failure of the Fed to be attentive to consumer protection issues in the build-up to the crisis had resulted in the impact of the financial crisis being more wide reaching than otherwise would have been the case. Advocates for a consumer protection bureau suggested that an institution solely focused on consumer issues would have been better placed to sound the warning alarm over the subprime mortgage crisis and housing market bubble (DePillis, 2014) (Interview35, 2016) (Interview37, 2016).

Consumer protection regulation was subject to little bureaucratic resistance (Woolley & Ziegler, 2012, p. 33). Although initially the FDIC opposed the agency, citing concerns over

budget loss due to not discharging consumer protection policy. This concern soon faded (Carpenter, 2010, p. 831). As a result, the Fed was the most influential bureaucratic actor in this space, operating in an environment of concentrated bureaucratic authority. No agency was seeking responsibility for this overtly political task. In addition given the Democrat majorities in Congress considered consumer protection a political priority, there were low political veto possibilities. The creation of this new institution, however, was subject to significant opposition from the financial industry. The on the face of it, the financial industry lobby appeared a formidable non-political veto player.

Both Dodd and Frank agreed with the Administration that being seen to punish the Fed in some capacity was a political necessity in order to reach agreement on the board package of institutional reforms (Associated Press, 2009) (Interview31, 2016) (Interview35, 2016) (Interview40, 2016). Consumer protection provided an excellent opportunity. Frank stated publically that:

> *"If I was going to list the top 87 entities in Washington in order of the history of their efforts on consumer protection, the Fed would not make it"* (Johnson S. , 2009).

The Fed was the sole bureaucratic actor. Whilst privately content with relinquishing consumer protection, the Fed maintained a public preference for the status quo. As an architect of the reform recalled:

> *"The official position was the Fed was against this…but they did not push back in any meaningful way"* (Interview39, 2016).

The evidence for this claim is outlined below. First, the Fed made the case publicly that it was capable of protecting consumers appropriately (Bernanke, 2009a) (Bernanke, 2009) (Interview38, 2016) (Associated Press Association, 2009) (Associated Press, 2009) (Zumbrun,

2010) (Carpenter, 2010, p. 836). Yet, when asked during a congressional hearing whether an independent consumer agency was required, Bernanke simply responded with: *"I'm not going to tell Congress what to do"* (Associated Press, 2009). This is noteworthy because Fed officials did not use such phrases whilst negotiating macro or micro prudential institutional reforms. Indeed, In January 2010 when Bernanke believed that the autonomy of monetary and micro prudential policy-making was at risk, the Fed issued an 11-page defence to the House and Senate emphasising the importance of the Fed's expertise to these capabilities (Bernanke, 2010f). It is telling that this same note did not include a single line in regard to the Fed's consumer protection expertise (Bernanke, 2010f). A senior Fed official explained the lack of defence in the written submission to Congress, stating:

> *"This [consumer protection reform] was a Congressional call. Our time was spent on what was the most important parts of the Bill to us – systemic designation and prudential supervision reforms."* (Interview40, 2016).

Second, the Fed Board feared it would come under political pressure if it retained consumer protection capability. Post-crisis consumer protection had become an overtly political issue. The majority of politicians were unhappy with the Fed's consumer regulation record. The Fed feared that politicians would be easily tempted to interfere in consumer protection judgements, thereby compromising its policy-making independence (Cooley, Schoenholtz, Smith, Sylla, & Wachtel, 2011, p. 62) (Miskin, 2009, p. 506) (Interview29, 2016) (Interview38, 2016). The Fed's fear was that once this occurred in consumer protection, it would spill over into financial stability and monetary policy (Interview29, 2016) (Interview35, 2016). As a result, Fed officials calculated that securing its autonomy could be better achieved by shedding its consumer protection responsibilities in order to insulate the central bank from political interference.

The consumer protection negotiation was subject to intensive bank lobbying. Investment firms did not fall within the scope of this negotiation and therefore did not seek to influence the process. Large and small retail banks opposed the creation of a powerful new consumer protection agency, however, and sought to veto its creation by influencing members of Congress. Barney Frank was able to take advantage of the fractional nature of the financial services lobby by splitting the small and large bank lobbies. During a speech he gave to the National Press Club on 27 July 2009, he noted:

> *"…And to the community banks, yes they have been unfairly traduced because they weren't the problem. But, they have to be careful not to allow themselves to be used by some of their big, big brothers who would like to have them shelter them. We can set up a consumer protection agency that will respect all of the community banks"* (Kus, 2016, p. 11).

In order to take advantage of the fractional nature of the financial industry lobby, Frank suggested that the CFPB's jurisdiction should extend only to banks whose assets exceeded $10 billion. This effectively excluded community banks from consumer protection. This allowed them to distance themselves from the bigger retail banks. Community banks withdrew their objections to consumer protection. Hence the veto power exercised in the macroprudential and micro prudential negotiations by a united financial industry lobby was significantly weakened. The intervention by Frank exposed the bigger retail banks as too weak to resist increased standards so soon after the crisis (Kus, 2016, p. 11). Large retail banks in isolation were unable to influence Democrat politicians on the issue because the Democrats were so publicly aligned with consumer protection regulation. Moreover, given public opinion on large banks in light of the crisis, Democrat politicians could not afford to be seen as lenient towards large banks in the lead up to the November 2010 mid-term elections.

This rationale for pursuing consumer protection is consistent with the political explanation, as politicians sought to enact consumer protection reform because the electoral gains outweighed the costs. The lack of unity within the financial sector was instrumental in CFPB becoming a central success of the institutional reforms, as removing community banks from the proposal freed up Democrats to impose the consumer protection provisions on the financial industry. It significantly reduced the flow of industry information to politicians. In doing so support for the whole package (macro and micro prudential) of institutional reform significantly increased amongst the Democrat majorities in Congress. The effect of splitting the financial industry lobby was to alter the environment in which consumer protection was negotiated. It was now characterised by concentrated bureaucratic power and low veto possibilities.

Despite this altered environment in which creating the CFPB in accordance with the Administration, Democrat, and Fed preferences appeared feasible, senior Democrats still made significant changes to the institutional arrangements. These changes further cemented support for the wider institutional reforms and are grounded within electoral competition. Despite being unable to veto the creation of the agency due to their lack of a majority in either the House or Senate, Republicans strongly opposed the creation of an independent consumer protection agency and stated their ambition to defund the programme should they gain a majority in the Senate (Quinn, 2010). As a result, subtle changes to the architecture were necessary to ensure a legacy of electoral benefit for the Democrats. This led Frank to recommend that the new agency make a call on the Fed's budget to exclude it from the appropriations process. Furthermore, Dodd took the decision to house the new independent agency within the Federal Reserve and to recommend the appointment of a single director. The Administration and Congressional Democrats viewed

the consumer protection institutional reform as the most tangible for the wider electorate, and therefore, as pivotal in showcasing how the institutional reform package would benefit Main Street (Interview37, 2016) (Interview32, 2016). Consequently, Democrats needed to ensure that the CFPB would provide a legacy for which they could claim electoral credit beyond the November 2010 mid-term elections. This late decision to adjust the agreed architecture is consistent with political explanations for institutional reforms.

The Federal Reserve Board was concerned with this revised institutional design (Interview38, 2016) (Interview31, 2016). Specifically, the Fed feared that housing the new CFPB within the central bank did not make a sufficiently clear statement that consumer protection was no longer a Fed responsibility (Interview38, 2016). Its preference was for the CFPB to be self-funded through legal action against firms (Interview29, 2016) (Interview30, 2016) (Interview35, 2016) (Interview32, 2016) (Interview38, 2016). Under the congressional proposal, the CFPB would be able to make a call on the Fed's operating budget of between 10-13%, blurring the lines of separation (Consumer and Financial Protection Bureau, 2018). Further, the Fed was concerned about the potential for the new agency to 'free ride' on the credibility and expertise of the central bank, yet make policy mistakes or controversial decisions that could damage the perception of the Fed's credibility (Interview38, 2016) (Interview40, 2016). The Fed would have no veto over CFPB decision-making, however, even if CFPB policy was counter intuitive to desirable prudential outcomes (Carpenter, 2012) (Interview37, 2016) (Interview35, 2016) (Interview32, 2016). For example, the CFPB might impose a large financial penalty on a firm, which would consequently impact the firm's capital position.

Despite this less than perfect compromise, the Fed retained a preference to delegate consumer protection policy in order to protect the macro and micro prudential institutional

reforms. Therefore the Fed chose not to resist the Administration and Democrat's politically motivated strategy. In the worst-case scenario resisting could have resulted in the collapse of the reform package, which would have represented a greater loss to the central bank. Whilst this compromise represented an inelegant solution for the Fed, it was one that broadly met its preference in hiving-off an undesirable function. It smoothed the road for macro and micro prudential gains that the Fed valued highly. The Fed did not wish to devote time to a battle that it could not win and that would jeopardise the overall institutional reform package. The concentrated bureaucratic authority allowed the Fed space to manoeuvre. First in agreeing to hive-off consumer protection jointly with the Administration; and second, as an opportunity to block the last minute changes to the CFPB's architecture. However Fed officials chose not to exercise its veto power for strategic reasons. This paved the way for Democrats to impose their preference for consumer protection on the industry.

Ultimately, Democrat majorities in both Houses were able to ensure the CFPB's creation. The Democrats' preference for pursing consumer protection is consistent with political explanations. It allowed Democrats to enter the 2010 elections with tangible evidence of placing Main Street ahead of Wall Street. The concentrated bureaucratic authority enabled the Fed to successfully pursue a bureau-shaping strategy of agency 'subversion': maximising its autonomy over desirable policy functions, while delegating an undesirable function to another bureau. As a result the final outcome is closer to the Administration and central banks preference, but represents a significant loss for the large retail banks.

5.5.4 Central bank independence

The final disaggregated negotiation concerns the level of oversight of the central bank. This negotiation represents an attempt by Congress to reign in the Fed's autonomy in core central banking operational and policy tasks: monetary policy-making and emergency

lending. The negotiation takes place directly between the individual(s) that proposed the amendment; and the Federal Reserve. Within this negotiation bureaucratic power is concentrated. The Fed is the only bureaucratic actor. There were no rival bureaux that could act as a lender of last resort or set monetary policy. Only a central bank can ease the creation of credit in the financial system during a crisis. The status quo institutional arrangement was that the central bank enjoyed full autonomy over monetary policy and emergency lending. As a result, and consistent with the bureaucratic politics proposition, we would expect the central bank to wield greater influence over the outcome and secure an arrangement closer to its own preference.

The outcome of the negotiation saw the Fed agree to publish the names of firms accessing its emergency lending facility, albeit with a two-year time lag. Monetary policy remained under status quo conditions. In the event of non-agreement between the two parties, the result is likely to be failure to enact any of the institutional reforms. This was because politicians were concerned about creating an overly powerful central bank without sufficient checks and balances. Overall the compromise reached represents a small loss to the central bank. Nonetheless, the outcome is markedly different to the proposal put forward by Congress. Congress began from a position of mandating an audit of monetary policy-making and emergency liquidity operations in real-time. As a result the outcome represents a significant loss for Congress.

Post-crisis the concept of auditing the Fed moved from the fringes of the political right to mainstream political and public dialogue (Jacobs & King, 2016, p. 146). On 19 November 2009 Representative Ron Paul secured an amendment to the D-F Bill in the House. The amendment permitted the Government Audit Office to review and audit monetary policy decisions (Bernanke, 2015, p. 451) (Paul, 2009a). If this remained in the final institutional

reform package, it would have represented a severe loss in autonomy for the Fed. It would have reduced the independence of the Fed's most prestigious capability by opening monetary policy decision-making to political scrutiny and control (Grim, 2011). The amendment confirmed the Fed's worst fears about the institutional reform process. The Fed believed the purpose of the amendment to be to make meeting-by-meeting monetary policy decisions subject to Congressional review and, therefore, Congressional pressure (Grim, 2011). The Fed considered its monetary policy independence as sacrosanct.

Paul used a House Financial Services Committee hearing in February 2010 to promote the idea of auditing the Fed by arguing the central bank had regularly overstepped its remit with the AIG issues being simply the latest example. Paul argued the Fed had been complicit in providing financing for the Watergate scandal and authoritarian regimes (Government Publishing Office, 2010) (Wyler, 2012) (Reddy, 2010). All Republicans and 15 Democrats members of the House Financial Services Committee voted in favour of the amendment (Andrews, New York Times, 2009) (Paul, 2009a). Thus far this process is consistent with what would be expected under the political explanations for institutional reform. The altered political environment forced politicians to reconsider preferences on central bank autonomy with a view to securing electoral gains or minimising loses, as all House seats were due for re-election in November 2010.

The Fed, along with Representative Frank, was unsuccessful in blocking the audit amendment in the House given the strength of anti-crisis sentiment on both sides of the political divide (Andrews, New York Times, 2009) (Grim, 2011). That is not to say members of the House were unsympathetic to arguments in favour of central bank independence. Rather they found it difficult to justify opposition to an *'audit'* at a point when the Fed was deeply unpopular amongst the electorate (Interview34, 2016) (Interview32, 2016)

(Interview40, 2016). House members considered the electoral gain from increasing central bank accountability to be greater than the costs incurred by fighting increased accountability, or criticism by the Fed (Interview39, 2016) (Interview38, 2016). The House midterms in November 2010 would see all 435 seats contested. The election gave every member an incentive to punish the Fed for its pre-crisis role as well as the AIG bailout and subsequent bonuses payments to AIG executives. The AIG bonus issue had turned public opinion firmly against the central bank.[14] Pre-crisis such an amendment would have been blocked after Fed intervention in the debate (Jacobs & King, 2016) (Interview40, 2016). In the absence of an imminent election it is likely that the Fed could have mustered enough support amongst politicians to defeat the amendment in the House. A number of similar Bills with similar objectives had been rejected during the pre-crisis years (Goodhart, 2014).

The Fed instead resolved to defeat the amendment in the Senate (Grim, 2011). To achieve this the Fed relied upon its financial market expertise relative to that of politicians. In the Senate only 37 of 100 senate seats would be contested in November 2010, thus electoral politics was easier for the Fed to counter. Independent Senator, Bernie Sanders, championed the 'audit' amendment in the Senate (Jacobs & King, 2016, p. 180) (Shiner, 2010) (Interview40, 2016) (Interview34, 2016). Fed officials met with Sanders' staff in order to negotiate a settlement that was acceptable to the central bank and the Senator, whilst ensuring that the important macro and micro prudential institutional reforms could still be enshrined in law (Shiner, 2010) (Jacobs & King, 2016, p. 180) (Interview34, 2016) (Interview40, 2016) (Interview38, 2016). Neither Sanders nor the Fed wished to be blamed for blocking important post-crisis institutional reforms. In addition, the financial industry lobby expressed a preference that senior politicians should not to impede the independence of the central bank (Jacobs & King, 2016, p. 147). Though the evidence suggests that the

[14] The Fed was at directly overseeing AIG following its collapse yet could not prevent bonus payments to executives at the firm.

industry was not a significant presence in the debate. This less activist approach by the financial industry is perhaps explained by the frequency with which the central banks autonomy has been threatened in the past (Goodhart, 2014).

Thus in order for the micro and macro reforms to pass, the Fed and Sanders' team worked to broker a compromise allowing for a form of central bank audit, that also sufficiently protected the Fed's independence (Brush, 2010a) (Interview30, 2016) (Interview40, 2016). The Fed successfully vetoed the audit of monetary policy. Ultimately, the Fed was successful in moving the negotiated agreement closer to its own preference, thereby safeguarding the passage of the institutional reforms. This was possible, in large part, due to the concentrated bureaucratic authority within this negotiation. Concentrated bureaucratic authority allowed the Fed to maximise the perception of its expertise and control the flow of technical advice to politicians. I argue that the concentrated bureaucratic power in this policy area enabled the Fed to pursue a bureau-shaping strategy of agency 'subversion': maximising its autonomy over a desirable policy function. The reminder of this section provides evidence for this claim.

First, the central bank signalled that the Paul amendment in its current form would mean the Fed would no longer be considered an independent monetary policy authority and, therefore, market confidence in the Fed's decision-making would be eroded (Brush, 2010) (Jacobs & King, 2016). This was its 'big bazooka'. Ben Bernanke described the implications of the audit amendment as follows:

> *"[the amendment means] if the Federal Reserve decided a year from now that because of incipient inflation it was time to raise interest rates, that the Congress would say, 'Ah, the GAO's going to audit that decision. It's going to subpoena your materials. It's going to demand information from members of the FOMC. It's going to*

evaluate your decision. It's going to report to Congress.' I don't think that's consistent with independence" (McCullagh, 2009).

The Fed issued briefings to politicians, arguing that this lack of independence would influence technocratic decision-making. One briefing stated: *"if policy-makers believed GAO audits would result in published analysis of their policy discussions, they might be less willing to engage in the unfettered and wide-ranging debates that are essential to identifying the best possible policy options"* (Grim, 2011).

Second, the Fed argued that secrecy around its LOLR function was critical to maintaining financial stability and therefore should not be subject to 'audit' (Johnson C. A., 2011, p. 303) (Grim, 2011) (Interview30, 2016) (Interview31, 2016). In turn, compromising financial stability would undermine macroprudential policy. Robust macroprudential policy was a key purpose of the institutional reform package and thus to undermine it would be counter intuitive. Specifically, the Fed suggested firms would not use the LOLR facility through fear of negatively impacting their share value, and inciting a run on a bank (Grim, 2011). The Fed argued this greatly increased the likelihood of market volatility, and, therefore, was counter-intuitive to the policy objective of the institutional reform package (Grim, 2011) (Interview40, 2016) (Interview31, 2016) (Interview30, 2016). In addition, the possibility of having to gain Congressional approval in order to grant an emergency loan presented the risk of politicising central bank decision-making (Johnson C. A., 2011, p. 303).

Realising that defeating the 'audit' amendment entirely was not a possibility given the strength of public and political anger with the Fed, the central sought to water down the impact and move the outcome back towards its preference (Jacobs & King, 2016, p. 180) (Grim, 2011). The red line for the central bank was compromising the independence of

monetary policy-making, a capability viewed as highly prestigious. In order to prevent this this, the Fed proposed the audit cover the terms and conditions imposed on firms accessing its LOLR facility during a crisis scenario only. This was a key element of the original 'audit' proposal (Interview34, 2016). However, in return, the Fed insisted that Sanders exclude monetary policy entirely from the audit amendment. A senior Fed official recalled discussing this with Sanders:

> *"We were certainly opposed to that [monetary policy audit], our feeling was that the ability for Congress to bring in the General Audit Office to open up the confidential files of the Fed was an additional level of political interference in monetary policy…motivated by a desire to simply control monetary policy"* (Interview38, 2016).

The central bank made clear it would publically oppose Sanders if he pursued a monetary audit (Page, 2010) (Interview40, 2016) (Interview38, 2016). The Fed also had strong backing from the Administration and could rely on the united financial industry lobby if required. Both actors opposed a monetary policy audit. Rather than risk escalating a public disagreement with Bernanke – who enjoyed a global reputation for strong technical expertise if not domestic popularity – Sanders opted to back down (Stewart, 2009) (The Economist, 2014). Whilst Sanders agreed to the monetary policy carve out, he remained adamant that the audit must include disclosure of the names of individual firms accessing the emergency lending facility immediately (Interview40, 2016) (Interview34, 2016) (Brush, Sanders agrees to modify Fed audit, 2010a). The Fed's strategic compromise did not go far enough in simply covering the terms and conditions of lending on an anonymous basis.

A further compromise was necessary in order for the macroprudential and micro prudential reforms to be safeguarded and prevent the collapse of institutional reform. The status quo was not an option for the Fed's detractors in Congress. As a result the Fed sought to

negotiate further on the audit of its LOLR function to generate a compromise that was relatively consistent with normative central banking practice (Kohn, 2014, p. 7) (Interview38, 2016) (Interview40, 2016) (Interview34, 2016). In searching for a compromise the Fed's incentive was to maximise the possibility of Congress approving its macro and micro prudential gains as part of the overall institutional reform package. The Fed proposed that that the audit on the LOLR facility should be subject to a two-year time lag. This would be based on the condition that the Chairman of the Fed could request that information passed on to relevant Congressional committees remained confidential (Johnson C. A., 2011, p. 303). The Fed believed this would be the best alternative in order to protect the effectiveness of the LOLR function (Interview40, 2016) (Shiner, 2010). Senator Sanders, and eventually other Senators seeking to increase accountability and transparency of the Fed, agreed. The compromise avoided a protracted and public disagreement with the central bank and ensured that neither party could be accused of stifling important post-crisis institutional reforms. This negotiated compromise was the audit function compromise that was ultimately included in the Act. One Fed official that participated in the negotiations described the compromise as follows:

> *"Was it ideal for the Fed? No. But it was certainly a better compromise than having the 'audit the Fed' option as it was passed in the House – infinitely better than that in fact"* (Interview40, 2016).

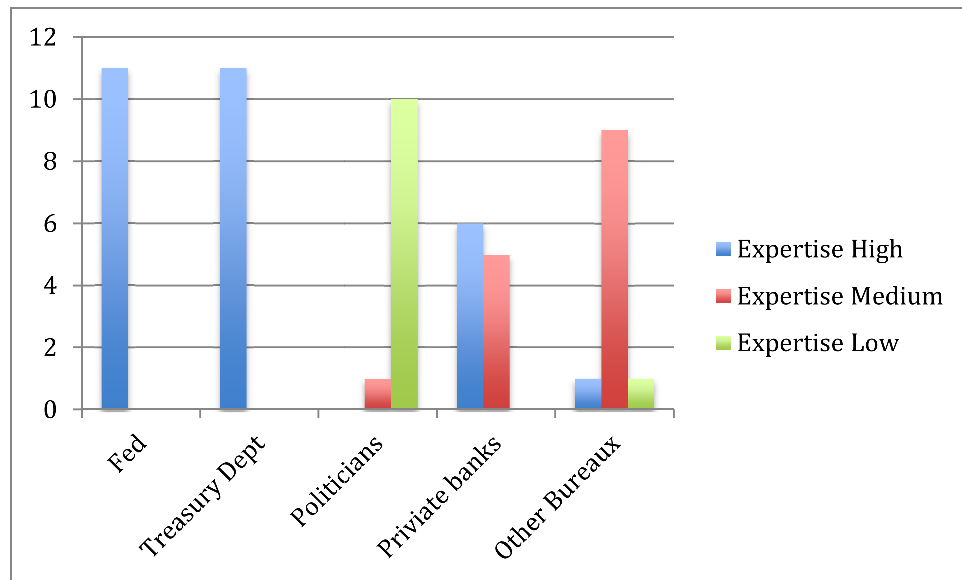
The Senate and House took opposing stances on this issue and ultimately the House backed down during the Bill conference in order to get institutional reform finalised ahead of the mid-term elections. The Senate, thanks to the compromise brokered between Sanders and the Fed, was able to argue the most important aspects of the audit the Fed amendment had been captured in the compromise. This ensured the Fed could not undertake covert lending

during a crisis. Faced with the political constraints of passing legislation in advance of mid-term elections, the House backed down and agreed to back the Senate version of the audit.

5.6 Sources of influence

The question remains, *what are the sources of influence that played a role turning institutional reform that was characterised by a backlash against the central bank into one that increased its capabilities?* Throughout the analysis there have been numerous references to high levels of expertise and bandwidth possessed by the Federal Reserve. The central bank in the US enjoys privileged access to both the Administration and Congress. Whilst other high profile bureaux may hold similar levels of access, the process reveals that the nature of the central bank's relationship with the Administration is markedly different. For example, the Fed co-authored the Administration's institutional reforms and the Treasury Secretary was a former Fed employee. In this sense the Fed is able to successfully influence the broad contours of the institutional reform from its earliest point. The same claim cannot be made about other bureaux.

Figure 8: Interviewee responses to perception of technical expertise on the issue of macro and micro supervision held by the institutional reform actors. (source: author's interview data).



Throughout the research conducted the process has revealed significant emphasis on the perception of greater expertise and bandwidth of the Federal Reserve, when compared to other actors in the process.[15] The Fed employs over 16,000 individuals, compared to 6000 at the FDIC and 5000 at the SEC (Federal Reserve Board, 2013) (FDIC, 2017) (SEC, 2013). The Fed has enormous resources in the form of hundreds of personnel with doctorates in relevant disciplines (Jacobs & King, 2016, p. 28). The Fed attracts PhDs from the most prestigious universities as well as private sector talent (Jacobs & King, 2016, p. 28). This increases the perception of the Fed's expertise when it advocates institutional reform preferences.

[15] Congress is represented by the label politicians in the bar chart analysis

This research has revealed all actors in the process perceived the Fed to possess high levels of technical expertise in the fields of macro and micro supervision. This was crucial when negotiating the outcome of institutional reforms with politicians. The process, however, reveals that in an environment of diffuse bureaucratic authority and significant institutional constraints, this does not always translate into more influence than rival bureaux or the financial services industry. The source of non-central bank bureaucratic actors' influence is less related to technical expertise and bandwidth, but rather intertwined with individual political aspirations. Interviewees did not consistently emphasise the expertise of other actors, with the exception of the Treasury.

The Fed has direct access to influential members of Congress, in particular Barney Frank and Chris Dodd. Though the same can be said of other agencies, the Fed used this line of communication to emphasise its credibility and expertise to the Senate and relevant committees, for example in its 11-page letter in January 2010. This letter alone referenced the central bank's expertise on 31 occasions (Bernanke, 2010f).

Furthermore, the process reveals the Fed often controlled the flow of technical information to individual members of Congress. Politicians were reliant on the Fed to make their ideas practicable (Interview29, 2016) (Interview38, 2016) (Interview39, 2016) (Interview40, 2016) (Interview31, 2016) (Interview32, 2016). This often allowed the Fed to undermine the arguments of politicians at their inception and ensure their final proposals were closer to the Fed's preferences. An example of this is the negotiation with Senator Sanders over central bank independence. This ability to control information stems from the Fed's long established position as an expert adviser to government. One Fed Board member commented:

"Congress and Fed were in daily contact…The Fed trying to say don't do this it's not a good idea – here is a better way of achieving this." (Interview38, 2016).

Treasury officials corroborated this account. One official stated:

"…the Fed have so much expertise in this area that its quite common place that you are on phone calls once per week to members of Congress and they are asking '"is this feasible?' You would see eyes roll because Treasury didn't agree with the policy direction – but asked if something is technically or legally feasible – the Fed would provide the appropriate advice" (Interview31, 2016).

The reputational damage to the Fed did not dampen politicians' perceptions of its technical expertise on macro and micro prudential policy. The public anger was borne from the Fed's role in the bailout of AIG (Jacobs & King, 2016, pp. 141-43). I contend that any damage to the Fed's technical authority was equal to or less than that suffered by its bureaucratic rivals (Financial Crisis Inquiry Commission, 2011, p. xviii). For example the Office of Thrift Regulation was abolished as a result of its supervisory role in the collapse of AIG. There was never any question of abolishing the central bank. Interviews conducted revealed the perceived expertise of other regulators remained much lower than Fed's. This was despite the bi-partisan criticism of the central bank by the same politicians. Whilst Democrats blamed the Fed for not caring enough about its consumer protection responsibility and Republican's disliked the fact that the Fed had been able to marginalise Congress in securing financial stability. Neither of these actions by the Fed suggests a lack of expertise on macro or micro prudential policy. One interviewee confirmed this, stating:

"My experience with other regulators, was that the Fed had expertise in markets and the economy that they just didn't have…When Bear Sterns declared on Thursday night that 'we cant open tomorrow morning' the FCC was totally shocked, well we

had been calling them all week saying "you've got a problem", but they just wouldn't believe it " (Interview38, 2016).

The central bank also operates on the assumption of institutional permanence that allows it to be more forceful in pursuit of its preferences. The Federal Reserve has been an independent central bank since 1913. Though there have been calls for abolition of the central bank from the fringes of the left and right, institutional abolition has never been mainstream political discourse. The Fed is safe in the knowledge that it will not be abolished for defying its principal in the same way that an agency regulator, such as the Office of Thrift Regulation, could be. For example, when confronted with threats to its independence the Fed showed it was prepared to signal to markets that it is no longer autonomous. The counter to this Fed expertise is the political institutional constraints within which negotiations takes place. Political Institutional constraints, for example the weak party system, allow space for multiple sources of non-expertise-based influence to veto institutional reform options. Examples of this non-expertise based actor influence include that exerted by the financial industry lobby, other bureaux, and individual politicians. Often these groups are helping to reinforce the status quo or, at best, limit the scope of reform.

Interviewees also considered the Treasury to possess strong expertise on the issue of regulatory architecture. This is for a number of reasons. First, the Comptroller of the Currency is housed within the Treasury. Though technically independent, the Treasury is frequently able to draw upon its analysis. Second, the Treasury Secretary and his Assistant Secretaries were appointed directly from academia and the central bank. For example Secretary Giethner was recruited from the Fed; and Assistant Secretary Barr, was recruited from the University of Michigan. It stands to reason that they would be perceived has having strong technical expertise. However, as the institutional reform process evolved the

Administration increasingly took a back seat, leaving the Fed to exert its influence in pursuit of institutional reform (Interview32, 2016) (Interview39, 2016) (Interview40, 2016).

The process also reveals that the financial services sector exerted significant influence over the outcome of the institutional reforms. Evidence suggests that the source of this influence is less financial and more economic. Whist, industry can donate to individual politicians, after the crisis politicians placed grater emphasis on the economics conditions within congressional districts through business lending. This influence helped financial industry lobbyists alter the course of the Administration's vision for financial reform by convincing individual politicians to veto the bureaucratic consolidation agenda and prevent radical institutional reform. Yet the process also reveals that the financial industry lobby is most effective when united in its preferences. In particular, the largest banks were relatively weak in the aftermath of the financial crisis and bank bailouts. Public opinion firmly opposed concessions for the largest firms. This made politicians less responsive to the concerns of the largest firms unless these concerns were shared amongst smaller firms, such as community banks. The strongest example of this is within the micro prudential and consumer protection negotiations.

5.7 Assessment of propositions

This chapter has documented the increase in capabilities of the Federal Reserve post financial crisis. It has done so by applying an ACI framework in which outcomes are the result of the interactions among actors, constrained by an institutional setting in achieving their preferences.

In summary, the outbreak of the financial crisis took all US actors by surprise. It was the critical event that forced political elites to reconsider their preferences regarding banking regulation. Without this re-configuration of political preferences the casual chain that

resulted in this specific institutional reform would not have occurred. It is not a forgone conclusion that Obama would have beaten McCain in the 2009 Presidential election and therefore the status quo arrangements could have remained. Nor is it a foregone conclusion that the Democrats would have gained control of the Senate and House (Holcomb, 2013). Whilst McCain was not an incumbent president, he had supported the economic and regulatory policies of the incumbent Republican President over the previous 8 years. McCain found it difficult to articulate a clear vision for institutional reform after Lehman Brothers collapsed. In contrast the Obama campaign had no record to defend on financial regulation and was unconstrained in articulating institutional reform that would result in significant electoral reward.

Based upon the predictions made in Chapter 2, if the main propositions hold true, the process should reveal the following institutional reform outcomes

Figure 9: Outcomes of US case study

Bureaucratic Structures

		Concentrated bureaucratic power	**Diffuse bureaucratic power**
Institutional Constraints	**High political veto possibilities**	*Absorption*	*Layering* **(Macroprudential & micro prudential)**
	Low political veto possibilities	*Subversion* **(Consumer reform; & central bank independence)**	*Displacement*

For the most part the US case provides an imperfect conclusion about the validity of the main and alternative propositions. It does not present a clear victory for the one specific set of propositions tested. At different points political explanations, bureaucratic politics and industry lobbying all influenced the final institutional reform. It is clear, however, that the explanations above are qualified by the institutional setting. Therefore the institutional constraints matter a great deal. The evidence also reveals that the epistemic communities explanation is significantly weakened. The remainder of this section discusses the competing propositions in turn.

5.7.1 Institutional constraints (P_1)

The significant institutional constraints in the form of a legislature highly independent of the executive, characterised by a Federal and Presidential system of government, made it difficult for the Obama Administration, or any other actor, to impose its own preference for institutional reform upon the process. The Administration's radical vision for institutional reform would have made the Fed the pre-eminent macro and micro prudential bureau. It would have simplified the architecture of the US financial regulatory landscape and reduced bureaucratic turf wars in the future through institutional consolidation. However, the institutional constraints ensured that the Administration's proposal immediately met with resistance on multiple fronts.

First, once the Administration had finalised preferences on institutional reform with the central bank, the process of legislative approval was not guaranteed. The "weak" party system means that despite the executive and legislature being controlled by the Democrats, the Administration cannot impose its preferences upon the legislature. This means political parties do not necessarily have clear and coherent positions on policy issues. Individual politicians careers are not directly tied to the patronage of the executive. Therefore the

prospect of mass defection and factionalism within political parties is high. In turn, the executive provides an important check on the legislative branch in the form of a legislative veto. However, the legislature may override a presidential veto with a two-thirds majority in both Houses of Congress. The result is that passing institutional reform is a complex process. President Obama indicated that he favoured gaining cross-congressional support for institutional reform. As a result this significantly empowered Congressional actors with veto power. The counter proposals by Senator Dodd for the creation of a new Financial Stability Agency and Financial Institutions Regulatory Administration, is one such example. Dodd was empowered to defy the Administration's proposal due to the independence of the legislature. A further example of the institutional constraints supporting divergence from the Administration's preference is the 'audit the Fed' amendment that passed in the House.

The Obama Administration opted to impose the strongest institutional constraint possible by codifying its institutional reform preferences in a White Paper published in July 2009. A White Paper is not a requirement. It represents a tactic to set a specific institutional reform agenda. It was designed to signal to Democrats the kind of institutional reforms their newly elected President wished to deliver in order to gain electoral reward in advance of the 2010 November mid-term elections and a future presidential election. It was the Administration's only tool to narrow the contours of institutional reform by focusing congressional debate on macro and micro supervisory reforms that the Administration wished to deliver. In contrast, the Administration did not take this approach with healthcare reforms. Instead allowing Congress free reign to deliver reforms that stalled before requiring executive intervention. Though non-binding on the legislature, the Administration believed that by setting a specific agenda the outcome of the financial institutional reform would better reflect its preferences. In theory, the White Paper introduced the possibility of a Presidential veto if

congress diverged too significantly from the institutional reforms laid out by the Administration.

As a result, as an absolute minimum, the executive's proposals for institutional reform are subject to the political institutional constraint of negotiation with Congress. For the most part the Administration's preferences directed congressional focus. It is reasonable to assume that in the absence of a White Paper, the Administration would have been forced into a more activist role in the reform process. For example, this could have occurred if Dodd's vision of reform been adopted by Barney Frank and other House Democrats.

Furthermore, the institutional constraints ensured that the Treasury's influence over regulatory bureaux was low. Each bureaucratic actor is independent of the Administration. A Treasury official described this institutional constraint as:

> *"The genius of having independent regulatory agencies…When the White House chief of staff summons the Treasury Secretary and says 'what the hell is going on, somebody just did X...which will cost us votes in Y!'. The Treasury Secretary can say 'I'm terribly sorry Mr President but they are independent and I can't do anything about it'"* academia or

This constraint is important as it meant the Treasury was unable to impose reform hierarchically upon regulatory agencies through bypassing congress. It also allowed bureaucratic agencies space to engage advocates to block the formation of the Administration's exclusive macroprudential council and veto proposals for micro prudential consolidation.

Overall, the institutional constraints created significant space for non-political actors to influence the institutional reform process. The weak party system and high levels of checks

and balances made politicians more reliant on outside groups for information. As a result, once the Administration's preferences for reform were revealed bureaucratic and industry actors sought to influence politicians and effectively generate institutional reform veto points. Once the Administration revealed its plan there was an immediate backlash from political, industry and bureaucratic actors.

As a result the evidence points towards an institutional context that matters a great deal – it sets the limits of executive action, determines the degree to which bureaucratic and industry actors are able to access the decision-making process and, more generally, renders courses of action less applicable while facilitating others. The institutional constraints and the conditions they created are a necessary condition in achieving the institutional reform outcome. As a result the proposition is supported by the research.

5.7.2 Bureaucratic Politics (P_2)

The financial regulatory architecture in place at the outset of the institutional reform process consisted of 12 bureaux. In the absence of so many bureaucratic agencies seeking to protect their capabilities the process of institutional reform would have met with less resistance. Turf wars are not uncommon in US financial regulation (Jacobs & King, 2016, p. 154). Whilst historically the architecture served a clear political purpose, this research reveals it now inhibits institutional reform leading to outcomes closer to the status quo. Any government, irrespective of partisan alignment, seeking to impose institutional reform would have encountered the same level of bureaucratic resistance. For example, the Hank Paulson institutional reform published by the previous Republican Administration in March 2008 would have proven equally unpopular amongst regulatory bureaux (Department of the Treasury, 2008).

Starting with macroprudential reform, the bureaucratic politics initially took place behind the scenes (Labaton, 2009). The Fed anticipated that institutional reform would be on the agenda given the severity of the crisis. The Fed accurately predicted this would entail bureaucratic politics. It was the central bank that began the bureaucratic politics behind the scenes in late 2008. This was a pre-emptive manoeuvre. The Fed created an internal task force headed by Kevin Warsh. Its role was to examine hoe to maximise the Fed's utility in the event of post-crisis institutional reform (Bernanke, 2015, p. 437) (Interview34, 2016) (Interview38, 2016). Bernanke selected Warsh for this role due to Warsh's significant political network. Critically, the Warsh report crafted a narrative that the Fed would use throughout the disaggregated negotiations on macro and micro prudential reform. The Fed undertook this internal exercise because it realised that the severity of the financial crisis would inevitably lead to institutional reform, which by definition entails bureaucratic losses and gains. This narrative argued that defects in pre-crisis regulatory approaches were a result of balkanisation, and could be remedied by increasing the Fed's policy-making authority. This internal work, completed whilst the crisis was still unfolding, enabled the central bank to articulate a clear set of preferences. The Fed used this clear set of preferences to guide the new Administration. The central bank played a key role in co-authoring the Administration's institutional reform proposals.

Second, once the Administration's preference for a small macroprudential council centred on the Fed was revealed, it immediately triggered bureaucratic competition (Labaton, 2009). No bureaucratic actor opposed the notion of macroprudential institutional reform as an idea – but each had strong preferences on the architecture. Sheila Bair, leader of the FDIC, insisted that the authority of other regulators should not be subordinate to a Fed-dominated macroprudential council. Instead, she argued for a powerful independent interagency council. Other bureaux heads supported this position because it maintained their existing

influence. Each agency had its own sphere of influence amongst political actors in Congress, which they exploited. For example, the FDIC utilised their personnel on secondments to congressional offices to ensure legislative members were briefed against the Treasury and Fed position on macroprudential reform. Similarly, the CFTC exploited the fact that it came under the jurisdiction of the Committee for Agriculture in Congress, mobilising the Committee membership into safeguarding the agencies future role (Interview30, 2016) (Interview31, 2016) (Interview38, 2016) (Interview39, 2016). The same process of bureaucratic opposition was critical in defeating Senator Dodd's proposal for new Financial Stability Agency.

In the absence of diffuse bureaucratic authority, it is reasonable to assume that the central bank would have been more influential in convincing Congress to pursue a macroeconomic institutional outcome closely aligned with its preference. The Fed would have been able to exclusively control the flow of information to politicians. In turn an environment of concentrated bureaucratic authority could have lessened industry influence over the macroprudential reforms. Namely, by removing the possibility of maintaining regulatory arbitrage across multiple agencies. In addition, without the Bair alternative proposition, if Congress wished to take a different course it would have had to invest significant time in finding an alternative institutional arrangement. This alternative would need to command a legislative majority whilst also being acceptable to a more powerful Fed. Yet bureaucratic politics alone is necessary but not sufficient in explaining the macroprudential institutional outcome. The financial industry could have sought to veto the Administration's proposal irrespective of the bureaucratic politics. The united industry lobby had strong veto powers given its strong links to individual politicians.

As a result the evidence significantly strengthens the bureaucratic politics explanation. It is classified as a necessary but not sufficient condition in explaining the macroprudential institutional outcome. The Administration abandoned its macroprudential preference as result of bureaucratic politics. This was despite Secretary Geithner's judgement that a wide-ranging committee would limit macroprudential capability and further enshrine bureaucratic politics is US financial regulation. Giethner argued: '*You can't convene a committee to put out a fire'* (Geithner, 2014, p. 403).

Turning to micro prudential reform, as with the macroprudential reform bureaucratic politics was a significant factor in defeating proposals for regulatory consolidation. The process of bureaucratic blockage mirrors that outlined in the macroprudential negotiation. For example, in responding to the Administration's proposal to consolidate supervision largely within the central bank, the head of FDIC, Sheila Bair, was relentless in defending her bureau's interests (Braithwaite, Scholtes, Duyn, & Guerrera, 2009). The Administration abandoned its pursuit of significant regulatory consolidation early on, due to bureaucratic politics (Interview32, 2016) (Bernanke, 2015, p. 443). The bureaucratic politics significantly reduced the scope for regulatory consolidation. This is as predicted by the bureaucratic politics explanation. The micro prudential outcome was close to the status quo. Only the Office for Thrift Regulation was abolished in the consolidation reform.

Dodd, however, was dogged in pursuing his preference for abolishing the central bank's supervisory divisions. The Fed had a preference for becoming the prudential regulator of all systemically important firms. The Fed believed it should have full regulatory control over these non-bank firms because the Fed would be expected to provide emergency funding to these non-bank firms in a future crisis. Within this environment the Fed was negotiating with Congress in an environment of more concentrated bureaucratic authority. This is

because no other agency had a strong preference for taking on prudential regulation of these firms. Doing so represented a reputational risk. A regulatory breach is inevitable and the regulatory bureaux will always be liable to reputational damage or abolition. In order to gain this capability the Fed accepted a Congressional compromise involving giving up community bank supervision.

Yet this compromise was also vetoed by bureaucratic politics. Within the Federal Reserve System bureaucratic authority is diffuse rather than concentrated with the Board of Governors. The Fed failed to anticipate the strong negative response from its Reserve Banks (Hoening, 2009) (Interview34, 2016) (Interview40, 2016). The Reserve Banks argued that stripping the Fed of community bank supervision was *"a travesty"* that would harm the *"best interests of the nation"* (Felsenthal, Fed officials warn against loss of bank oversight, 2010a). Reserve Bank's claimed switching the Fed's supervisory focus to the largest firms would create a *"central bank of Wall Street and not the United States"* (Felsenthal, 2010a). The Reserve Banks also emphasised the impact of their knowledge on informing monetary policy decision-making. The Reserve Banks were able to veto the compromise by generating sufficient political and industry opposition to it. The Reserve Banks were aware that the perception of the central bank is critical to its credibility. Disunity within the Federal Reserve System represented a threat to that credibility. By chance the unanticipated intervention by the Reserve Banks increased the Fed's bargaining power. It did so by creating a coalition between the Federal Reserve, industry and politicians that vetoed Dodd's proposal. Whilst no new institution was layered on top of the existing architecture, the outcome did represent an incremental change in institutional rules. As a result the bureaucratic politics explanation is an important element of the micro prudential negotiation. The proposition is significantly strengthened, though cannot be entirely disaggregated from the financial industry lobbying proposition.

The micro prudential and macroprudential negotiations sit in contrast to the consumer protection negotiation. The later negotiation was conducted in an environment of concentrated bureaucratic authority. The status quo consumer protection rule-making power was consolidated in the central bank. In line with the predictions on bureaucratic politics and institutional constraints, an outcome of institutional subversion would be expected. The lack of bureaucratic rivalry for consumer protection rule writing authority allowed the central bank significantly more room for manoeuvre. No bureau was actively seeking the capability. Each agency viewed consumer protection as inherently political because it had become a primary objective of the Democrats in a post-crisis environment.

The Fed had always considered consumer protection to be a fourth order objective. It ranked behind monetary policy, financial stability and micro-supervision in terms of prestigious policy tasks (Interview40, 2016) (Interview38, 2016) (Interview31, 2016). It was agreed in early 2009 with the Administration that consumer protection authority would be hived-off because it was viewed as the best way of achieving the macroprudential and micro prudential authority that the Fed placed significantly greater value on. The Fed feared political pressure would be placed on the central bank if it retained consumer protection rule-writing authority because Democrat politicians were unhappy with its consumer regulation record. This in turn may have led to political interference and thus its ability to conduct monetary policy and perform systemic or prudential regulation independently (Cooley, Schoenholtz, Smith, Sylla, & Wachtel, 2011, p. 62) (Miskin, 2009, p. 506) (Interview29, 2016) (Interview38, 2016). For example, in the event of misconduct by a firm the Fed may come under significant public pressure, and therefore political pressure, to impose large fines on a firm. Yet such a course of action could severely compromise a firm's safety and soundness, leading to a capital and liquidity stress, which in turn may cause a financial stability event. This was a conflict that the Fed calculated was not necessary.

In the event of significant bureaucratic contestation within the consumer protection negotiation it is likely that the scope for reform would have been significantly reduced. For example, if each agency wished to return a role in consumer protection regulation, it is plausible that the outcome could have been one of institutional layering. The outcome of the consumer protection institutional reform is not exactly as the Administration or Fed envisaged. Non-bureaucratic variables influenced the final architecture, yet the outcome does free the central bank of consumer protection responsibility. As a result the highly concentrated bureaucratic power within consumer protection is an important element of the explanatory process.

With regard to the central bank independence negotiation the Fed was operating in an environment of concentrated bureaucratic authority. The independence negotiation was not part of the Administration's initial package. It was the result on an amendment to the institutional reform proposed in the House by Ron Paul. The political veto possibilities were relatively low. Despite many politicians not agreeing with the notion of revoking central bank independence, politicians were fearful of blocking the amendment due to the optics of doing so. As a result the negotiation of importance to the institutional reform outcome took place between Senator Sanders and the central bank, as the concept was debated in the Senate. The bureaucratic structure provided the Fed with sufficient scope to influence Senator Sanders. Sanders was reliant on the central bank to provide technical information. The Fed controlled the flow of information. As a result the Fed was able to move the outcome closer to its own preference. This outcome significantly strengthens the bureaucratic politics proposition.

5.7.3 Political explanations

Political explanations are an important element of the casual chain leading to the institutional outcomes. Therefore political explanations cannot be dismissed. The reasons provided by the Obama Administration and congressional Democrats in pursuing institutional reform are clear. The crisis was used as a tool for electoral reward and there was a limited window of opportunity within which this could be achieved. In the absence of a preference from the Administration financial regulatory institutional reform would not have followed the process it did. Congressional Democrats viewed the crisis through the same strategic lens as the Administration. They had a preference for passing institutional reform in advance of November 2010 mid-term elections. Without this political drive for reform the interactions amongst politicians, bureaucrats and industry would not have taken place. Throughout the institutional reform process political actors across the executive and legislature where focused on strategies in pursuit of electoral gain.

First, the Obama campaign generated broad preferences for institutional reform prior to taking office as a result of the high profile nature of the crisis and mass public anger at bank bailouts (Obama, 2008a) (Bernanke, 2015, p. 437). This was done to capitalise on the public discontent with the goal of securing electoral victory in November 2009. For example, on 27 March 2008, candidate Obama made a campaign speech in which he directly associated Senator McCain with the de-regulatory agenda of the incumbent Republican President (Obama, 2008a). At the same time, Obama put forward preferences for institutional reform (Fifield, 2010) (Geithner, 2014, pp. 400-401). (Interview29, 2016) (Interview30, 2016) (Interview31, 2016). This was done to highlight the difference in approaches to the on going crisis and convince the public to vote for candidate Obama over McCain. For example, Obama called out the McCain campaign on its lack of ideas about how to fix banking regulation, stating:

> “…he [McCain] isn't offering real solutions, he can't talk enough about how greedy Wall Street is, and how he's going to take on that ol' boy network in Washington” (Obama, 2008).

This rhetoric ramped up following the collapse of Lehman Brothers in September 2008. The impact of this overtly political tactic is clear, as media coverage of McCain became markedly more negative in tone as his ties to the incumbent Administration’s decisions made it difficult for him to articulate credible institutional reform (Holcomb, 2013).

Second, once in office realising an associated electoral pay-off or the institutional reform drove the Obama Administration and congressional Democrats. This was advocated directly by the Whitehouse Chief of Staff, Rahm Emanuel (Interview30, 2016) (Interview31, 2016) (Interview32, 2016). One Treasury official recalled:

> *“…they [political principals] feared – rightly in my view – that the political economy window for change would close. So there was a trade-off in time. You wanted to act soon enough so that the political space was still there to make meaningful reform”* (Interview31, 2016).

This window discussed amongst Democratic Party members was the 2010 mid-term elections. As a result pressure was applied by the Administration and Congressional Democrats facing re-election in November2010 on senior Democrats in Congress, as the institutional reforms appeared to stall in mid 2010. This, in part, forced Senator Dodd to back down from his radical vision of institutional reform, which would have stripped the Fed of all supervisory authority. Dodd’s opposition also fell away after taking the decision not to pursue re-election. Therefore Dodd’s primary incentive to pursue radical reform fell away (Ferraro & Holland, 2010). This strengthens the argument that political preferences are developed for electoral gain and therefore an essential element of the institutional reform explanation.

Third, the Democrats pursued the creation of a new powerful consumer protection agency because it was critical to the Democrats re-election strategy. It was also critical to ensuring Democrat votes for the entire institutional reform package. It was this political explanation that drove the final design. Democrats perceived consumer protection reform to be the most tangible aspect of the institutional reform for the electorate. Democrats had an incentive to pass consumer reform and lock in its existence. The political factors explain the last minute changes to the architecture of the CFPB (Quinn, 2010). Democrat politicians did not oppose the Administration's architectural concept. If Democrat politicians were satisfied with creating the CFPB and claiming electoral credit for one electoral cycle they would have passed the institutional reform as intended by the Administration. They had the legislative majorities to achieve this outcome. Rather, it was the opportunity to claim credit for every action a new consumer protection agency would take against unpopular large banks beyond its initial inception that drove Frank to recommend that the CFPB should be excluded from the appropriations process. Dodd took the decision to house the new independent agency within the Federal Reserve and to recommend the appointment of a single director, for exactly the same reasons. The outcome of the consumer protection negotiation supports the political explanation. It was politically crucial to ensuring the macro and micro prudential institutional reforms.

Finally, the issue of central bank independence formed an element of the institutional reform due to political preferences (Bernanke, 2015, p. 451) (Paul, 2009a). Paul had a long held preference for politicising the Fed's decision making. For example, Paul promoted his 'audit' amendment at an opportune time, when the central bank was deeply unpopular due to its role in the AIG bailout, and all House Representatives were facing re-election in 2010 (Appelbaum & Dennis, 2009) (Dennis, 2009). Politicians were conscious of the potential for electoral losses that could follow from opposing an institutional reform marketed as

increasing transparency and accountability of a traditionally secretive bureau**.** The result was that the 'audit' amendment tied the hands of House members. House politicians calculated the electoral costs of vetoing the Paul amendment as too high given the external environment. Yet, when the Senate voted on the amendment, it had undergone significant changes to remove the monetary policy audit. In contrast to the House electoral position, the Senate 2010 mid-term elections would only see 37 of 100 seats contested. The Senate was under less immediate electoral pressure. This allowed other actors the scope to negotiate in the Senate. In the absence of near-term electoral interests, it is plausible that House politicians would have vetoed the amendment.

It is clear that preference formation is heavily grounded in political competition. Yet, there is a weakness with the political explanations proposition, as explained by the literature. It assumes that politicians conceive of institutional reform as tool for electoral victory and then implement the reform hierarchically in order to reap the electoral rewards in the future. The process reveals that the Administration was unable to impose its institutional reform preferences in a hierarchical manner in the macroprudential, micro-supervisory and central bank independence negotiations. For example, the Administration was forced to back-down over its desire to empower the Federal Reserve as a macroprudential lead within a re-vamped President's economic council of advisors. The process revealed the Treasury Secretary's frustration with the institutional outcome (Geithner, 2014, p. 403). Instead it had to accept an interagency council of regulators – because the Administration could not impose its preference on the legislature. Second, at a micro prudential level the Administration was unable to overcome bureaucratic politics in order to ensure significant regulatory consolidation. Third, the Administration, and senior politicians such as Barney Frank, were unable to prevent Senator Dodd from proposing a diametrically opposed version of institutional reform to the Senate. The Democrats were politically divided

regarding the type of institutional reform to pursue for much of the process. Similarly, Dodd was in turn forced into making compromises and was unable to impose his reform preferences on macro and micro prudential negotiations. Finally, when negotiating central bank independence the outcome is markedly different to the original intention of politicians.

This all occurred despite the Democrats controlling both legislative branches of government. They held 233 seats out of 435 in the House, after the November 2008 election. In the Senate they held control, with 57 of 100 seats. In both legislatures a simple majority required to pass legislation. The only negotiation in which political preferences dominate the process appears to be related to consumer protection. Given the importance of the consumer protection negotiation to securing the institutional reform package, the political explanation cannot be rejected outright.

In summary, the political explanation in isolation does not account for the exact nature of the institutional reforms. The Administration's political preferences are critical to the process of institutional reform, in that their absence would not have triggered the bureaucratic or industry interventions. Yet, bureaucratic or financial industry actors directed, more often than not, political preferences once the institutional reform negotiations began. As a result the political explanation receives mixed support in explaining the outcome of the institutional reform outcome.

5.7.4 Financial Industry Lobbying

Much of the financial industry lobbying literature suggests that the US financial services lobby is powerful due to the resources it can devote to achieving its preferences (Fligstein, 2001; Krippner, 2005, 2011; Epstein, 2005; Palley, 2007; Orhangazi, 2008; Davis, 2009; Tomaskovic-Devey and Lin, 2011). Judging by the evidence, financial industry lobbying had

significant influence on the institutional reform outcome. Yet, I argue that the largest banks were relatively weak as a result of the crisis when isolated from their smaller banking peers. This is because coordination amongst the factional financial services lobbies matters (Woll, 2014).

Given the centrality of large banks to the crisis, it is not surprising that their popularity amongst the public dived considerably after 2008. Public confidence in large banks was at 4% in 2009, down from 11% in 2008, and down from 30% in the pre-crisis years (Bowman K. 2018, p. 6). Politicians were acutely aware of the electoral consequences of conceding institutional reform to this unpopular faction of the banking industry. In contrast, community banks were not considered responsible for the crisis (Lewis, N/A). The influence of community banks is clear from an assessment of their numbers. Prior to the crisis, the Fed was responsible for overseeing around 5,000 bank holding companies and 850 state-chartered banks that are part of the Federal Reserve System. There is at least one community bank in each congressional district (The Economist, 2019). As a result, they are responsible for a significant volume of economic activity within politicians' constituencies. In the aftermath of the crisis community banks remained relatively strong across a range of metrics, from lending growth to geographic reach (Council of Economic Adivsers, 2016, p. 1). Thus I contend that smaller, community banks are responsible industry influence on the institutional reform outcomes. The evidence to support this claim is below examined below.

First, the use of macroprudential policy tools tends to impact the largest firms; with the biggest balance sheets; and therefore greater lobbying resources. However, the Administration's macroprudential institutional reform proposal impacted all firm types. No firm opposed the idea of macroprudential reform because all firms benefit from the perception of a financial stability gap being addressed. Federal Reserve Board member,

Kevin Warsh, summarised the industry's position as follows: *"No matter what they and their lobbyists say, they want us to be their regulator more than they can possibly contain themselves – mostly for our credibility and mostly for our balance sheet"* (Rushe & Moore, 2014). The coordinated financial industry lobby wished to veto reform that diminished prospects for regulatory arbitrage. It was this aspect of the institutional reform that united the factions of the financial services lobby. Firms opposed the Administration's approach because it locked smaller agencies out of the decision-making progress. Larger firms feared a closed-off macroprudential council centred on the Fed would make it far more difficult to veto changes in bank capital standards or leverage at a future time. Smaller firms feared it would create an unlevelled playing field in which policy-makers would focus on the largest firms to the determent of banking competition. The status quo institutional arrangements provided ample opportunities to lobby individual politicians. As a result, the financial services lobby, led by community banks, formed a coalition with smaller regulatory bureaux to veto an architecture that jeopardised its influence over regulatory affairs. Community banks were able to exerting influence over politicians by arguing that economic activity would be impaired within individual congressional districts. Faced with this prospect, politicians threatened a legislative veto and forced the Administration and other actors to change course.

In the absence of community bank lobbying, politicians are less likely to have been responsive to the lobbying of large banks in the immediate aftermath of the crisis. Community banks provided cover for the larger banks to achieve their preference on macroprudential reform. In doing so it also allowed the industry to veto Dodd's more radical proposal for a new systemic regulator.

The process of stifling micro supervisory reform closely mirrors that revealed by the macroprudential negotiation. The evidence for this claim is as follows. First, industry lobbyists opposed regulatory consolidation on the basis that the status quo provided significant opportunities for venue shopping and arbitrage. This was achieved through a combination of the industry's financial influence as well as playing on the political fears of Congressional politicians. Large and small firms argued wholesale consolidation would result in years of disruption (Appelbaum and Dennis, 2009). Smaller firms argued that creating a single banking regulator, as per Dodd's proposal, would put them at a significant disadvantage. Small firms rehashed the level playing field argument, suggesting bigger banks would dominate the agenda of a single regulator. This was the same argument articulated by bureaucratic actors. Under the status quo, smaller banks are able to gain greater traction for their specific policy concerns. This idea that big banks would dominate the regulatory agenda gained significant traction amongst politicians keen to be seen to deal with the power of big banks rather than support an institutional arrangement in which big bank influence would thrive. Given the lack in public trust of large banks, it is likely that in the absence of community bank advocacy that the 'disruption' argument of large banks would not have gained sufficient traction such that it would have prevented regulatory consolidation.

Second, industry lobbyists pointed to the Dodd proposal for a single prudential regulator as a proven failure. The American Bankers' Association made comparisons to the UK's single micro supervisory agency, the FSA, arguing *'It failed miserably"* (Kus, 2016, p. 5). This observation garnered sympathy amongst many in Congress and was also the view of the Fed and Administration.

Third, albeit by chance community bank lobbying was crucial in the Fed retaining community bank supervision (Kus, 2016, p. 5). It is inconclusive in the process whether community banks bolstered the Reserve Banks' campaign to retain supervisory authority; or whether community banks influenced the Reserve Banks to oppose the negotiated agreement. Nonetheless the community banks had a self-interested motive in remaining under the supervision of the Federal Reserve System. As member banks of the Reserve System, community banks can exercise significant influence over the governance of a Reserve Bank. Member banks hold stock in the Federal Reserve Banks and earn dividends. Member banks also appoint six of the nine members of each Reserve Bank's board. This close relationship and influence over a regulator would be difficult to replicate. As a result the Reserve Bank members had a strong incentive to intervene in the negotiated compromise agreement. Without this industry lobby collaborating with Reserve Banks, the Fed Board would have remained loyal to the compromise agreed with Congress. Dodd and other Senate committee members may not have backed down from their preferences without the additional incentive of community bank industry influence.

In respect of the consumer protection negotiation, the financial industry failed to prevent the creation of a powerful independent consumer protection agency. Investment banks were not within scope of consumer protection and therefore were not involved in the process. Initially both large and small retail banks were within the remit of the reform. These groups opposed the creation of a powerful the consumer protection agency and sought to block it by influencing members of Congress. However, Barney Frank was able to take advantage of the fragmented nature of the financial services lobby by isolating larger banks. During a speech on 27 July 2009, Frank stated*: "We can set up a consumer protection agency that will respect all of the community banks"* (Kus, 2016, p. 11). Frank suggested that the CFPB's jurisdiction should extend only to banks whose assets exceeded $10 billion.

Therefore, small banks distanced themselves from the big banks (Kus, 2016, p. 11). This left the bigger banks, too weak to exercise a veto on consumer protection in the immediate aftermath of the financial crisis. The Democrats had campaigned on the issue of consumer protection and thus would not alter this preference on the basis of large retail bank lobbying alone. This lack of unity within the financial sector mattered a great deal in the creation of the CFPB. As a result the financial sector lobbying explanation regarding the outcome of consumer protection negotiation is significantly weakened.

The evidence suggest that the financial industry lobby played a small role in convincing the Senate to reject the 'audit' of monetary policy amendment that passed in the House. Though it was significantly less proactive on the issue when compared to micro and macro prudential negotiations. The idea of a central bank, whose monetary independence is compromised, is not an appealing idea for banks or business (Jacobs & King, 2016, p. 147). Banks and businesses used their connections to politicians to relay these fears (Jacobs & King, 2016, p. 147). The financial sector lobby feared a lack of monetary autonomy would destabilise the economy and make it more vulnerable to debt-related crises. For example, during times of recession, governments borrow more to pay off debt. They would likely tighten spending or increase tax revenue, which in turn can decrease aggregate demand and generate unemployment. If the central bank cannot adjust monetary policy accordingly to compensate for this, then lenders will anticipate default and be unwilling to roll over the government's debt (Bianchi & Mondragon, 2018). Nonetheless, the on the basis of the evidence the financial sector was unable to exert influence in order to prevent significant change to the way in which the discount window operates. It is reasonable to assume that the financial sector would not be in favour of a public register, even if subject to a time lag, given the impact such information might have on share price. As a result, based on the

evidence, the financial sector had little influence over the central bank independence negotiation.

In summary, the push for institutional reform in the US was largely hostage to the community bank lobby. When coordinated the financial industry was able to veto political preferences and produce outcomes closet to the status quo on macro and micro prudential institutional reform. The consumer protection negotiation provides an ideal counterfactual test. When industry factionalism was exposed, the larger banks struggled to influence the institutional reform outcome. The source of bank influence is less related the financial power of large banks, and more related to the economic importance of smaller community banking activities, such as business lending, in the aftermath of a severe financial crisis. In order to be effective the larger banks needed the cover provided by the untainted smaller banks. As a result the influence of the financial industry lobbying explanation on the outcome of the macro and micro prudential negotiations is strengthened, but cannot be entirely disentangled from the bureaucratic politics explanation. Nonetheless it is the institutional constraints that allow the financial industry significant scope for intervention.

5.7.5 Diffusion of Ideas and Epistemic community

This research significantly weakens the epistemic community proposition as an explanation for the outcome of the institutional reform. Prior to the period being studied macroprudential ideas had been discussed amongst the BIS members but only in small enclaves (Baker, The New Political Economy of the Macroprudential Ideational Shift, 2013). The financial crisis gave macroprudential policy an extraordinary boost (Borio, 2009, p.32). As Borio has pointed out, '*a decade ago the term macroprudential was barely used and there was little appetite amongst policy makers and regulators to even engage with the concept, let alone strengthen macroprudential regulation'* (Borio, 2009, p.32) (Baker, The New Political Economy of the Macroprudential Ideational Shift, 2013). This was certainly the case

in the US. Under the leadership of Alan Greenspan the Fed opposed the adoption of macroprudential regulation in the decade prior to the crisis (Goodhart, 2014, p. 6) (Baker, 2013, p. 119). In a speech in October 1999, Greenspan argued:

> *"Heavier supervision and regulation designed to reduce systemic risk would likely lead to the virtual abdication of risk evaluation by creditors. The resultant reduction in market discipline would, in turn, increase the risks in the banking system, quite the opposite of what is intended"* (Greenspan, 1999).

Pre-crisis, US regulatory bureaux and politicians had bought in to the idea that markets were rationale and increasingly self-regulating after decades of unprecedented growth (Jacobs & King, 2016, p. 22). Since the mid-1990s the pro-market policies that Greenspan and his fellow regulators advocated seemed to have delivered record growth, falling inequality, lower rates of crime, and lower unemployment for disadvantaged minorities (Mallaby, 2016). The slowly escalating series of bank exposures to US sub-prime mortgages between February 2007 and August 2008 alone were not enough to shift this belief. This is despite the concept of macroprudential policy having existed for a significant amount of time.

However, on 15 September 2008 when Lehman Brothers investment bank filled for bankruptcy, the Fed came to the realisation that a new institutional approach was politically inevitable. The central bank's preferred method of convening the financial industry to deal with weakening banks had failed in resolving the problems at Lehman Brothers (Woolley & Ziegler, 2012, p. 43).[16] It was at this point the epistemic community that had been quietly advocating the importance of macroprudential capabilities gained a vehicle for its ideas. Politicians began to search for a solution to the worst financial crisis in living memory (Baker, The New Political Economy of the Macroprudential Ideational Shift, 2013). The epistemic

[16] Bear Stearns and Merrill Lynch were absorbed by competitors.

community grew louder and gained more traction as the existing paradigm of regulation broke down. BIS economists were joined by prominent academics such as Charles Goodhart, Jose Ocampo, Stephany Griffith Jones, John Eatwell and Martin Hellwig (Baker, 2013). This increased the volume of the call for macroprudential policy.

The Obama Administration agreed with introducing macroprudential policy because it represented an opportunity for a symbolic break from the past and '*promised to limit future potential market losses, to reduce future calls on public finances'* (Baker, 2013). It was a political opportunity rather than underpinned by a long-held belief in macroprudential ideas. There is no evidence to suggest Obama had mentioned the concept in public prior to 2009. There is no evidence to suggest the Obama Administration's exposure to an epistemic community influenced its decision to pursue macroprudential institutional reform.

It was the Fed's conversion to the macroprudential cause rather than an epistemic community that explains the new Administration unveiling a plan for macroprudential institutional reform. It was the central bank that set the Administration's preferences as it seconded employees to draft the Administration's White Paper. The process reveals that Ben Bernanke adopted the role of policy entrepreneur to provide the Fed with a convenient way of protecting the its existing capabilities. It was not a result of *"a shared set of normative and principled beliefs"* (Haas, 1992, p. 3). The decision to adopt macroprudential policy was a direct consequence of Bernanke tasking Kevin Warsh in late 2008 with considering the potential for regulatory disruption, given the extent of the financial crisis (Bernanke, 2015, p. 437) (Interview34, 2016) (Interview38, 2016). Henceforth, the Federal Reserve's defence of its existing capabilities was recast in terms of macroprudential policy – a gap in the pre-crisis architecture that had hindered the central bank in its pursuit of financial stability (Borio, 2009, p.32) (Goodhart, 2014, p. 6). The central bank suggested

regulators could not have spotted the crisis without macroprudential authority nor could any meaningful regulatory action have been taken.

The influence of an epistemic community of experts is weakened as an explanation for the macroprudential institutional outcome. Senior US regulatory officials had marginalised the macroprudential policy epistemic community that had advocated for macroprudential policy decades earlier (Baker, 2013) (Balzil and Schiessl, 2009). It was only once institutional reform became apparent through political pronunciations that there was a growing chorus of converts to the macroprudential cause – led by the Fed (Bernanke, The Public Policy Case for Role for the Federal Reserve in Bank Supervision and Regulation, 2010f) (Bernanke, 2010e). Unsurprisingly, this sudden change in preference to support macroprudential policy did not convince all actors that the Fed should be empowered as the sole macroprudential regulator. It may, however, have placed some additional pressure on politicians to ensure that the Fed should have a role in discharging macroprudential policy.

It is clear that the majority of politicians had bought into the need for macroprudential policy. However, each actor in the process had competing visions of how it should be implemented. For example, the Administration's preference was to empower the Fed as the sole macroprudential actor; whereas Chris Dodd advocated a new Financial Stability Agency. The Fed was able to paint Dodd as out of line with institutional reforms being debated internationally, which were empowering central banks with new macroprudential responsibility (Borio, 2009). The Fed insisted that only it possessed the expertise to discharge macroprudential policy effectively. For example, Bernanke wrote to Congress stating:

> *'[the Fed] has deep expertise in the areas of macroeconomic forecasting, financial markets, and payments systems. As a result of its central banking responsibilities,*

the Federal Reserve possesses expertise in those areas that is unmatched in government and that would be difficult and costly for another agency to replicate' (Bernanke, 2010f, p. 1).

There is no evidence to suggest that the location of micro supervisory authority was subject to a great ideational shift following the financial crisis. The approach remains one of regulators asking firms what they are doing, rather than telling firms what they should do. The evidence for this claim is that different types of agencies in each jurisdiction conduct micro supervision across the UK, Eurozone and USA. There have been no publications on the best institutional design for micro supervision by the BIS, for example. Rather, domestic actors and institutional constraints, provide a far more compelling explanation of the micro-supervisory institutional reform outcomes.

Finally, the evidence does not suggest any influence of an epistemic community over the independence of the Fed negotiation. The Fed has always been an independent central bank. Moreover, the debate about central bank influence took place during the late 1980s and early 1990s. It was an element of the institutional reform that was unique to the US and therefore subject to the influence of actors at a domestic level. Therefore the epistemic community explanation can be rejected here.

Ultimately the way in which expertise had an influence on the outcome of the institutional reform was not through a shared belief amongst an epistemic community of experts, but rather as a power resource that allowed the central bank to play a role in steering outcomes closer towards its preferences; or stifle reform and ensure the status quo remained in place. Despite the unpopularity of the Fed, politicians still believed that they had to rely on its expertise and advice. This is clear in the allocation of macroprudential supervisory

authority; the defence of the Fed's micro supervisory capabilities; and the protection of its independence.

Chapter 6. Bank of England and post-crisis reform

6.1 Introduction

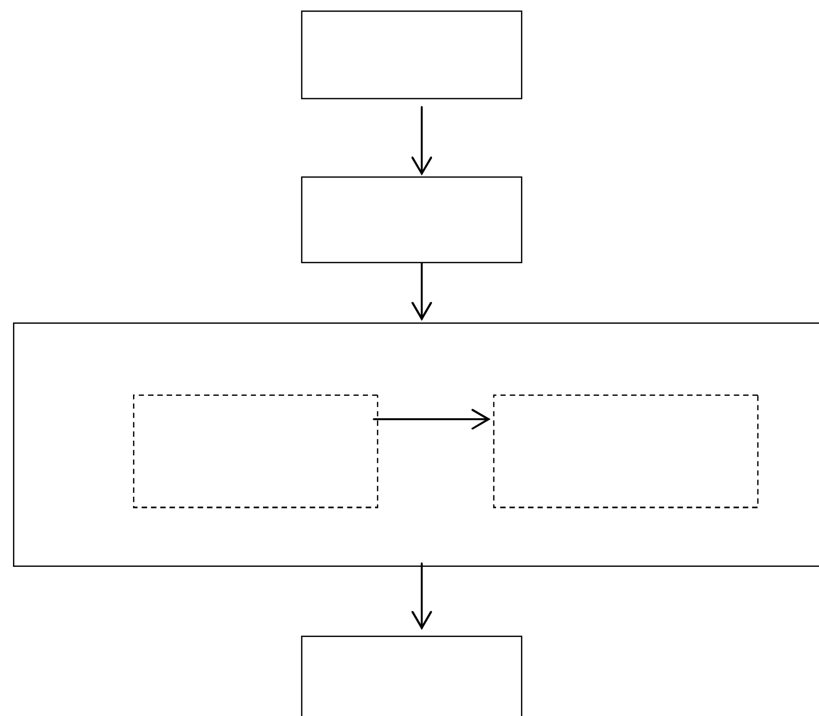
The Bank of England has experienced the most important and far-reaching institutional reforms in a generation since the UK suffered the worst financial crisis in living memory. The UK was amongst the most severely hit due to the magnitude of its banking industry (Quaglia, 2009, p. 1067). Banking represents a disproportionately large percentage of the UK economy, and has done so since the late 1980s (Moran, 1991, p. 55). The crisis resulted in bank runs and subsequent nationalisations. The UK government intervened to inject £37 billion into three large banks as they stared over a precipice (BBC, 2008). The immediate post-crisis years (2008-2012) saw significant reform of the banking regulatory architecture, cumulating in the Bank of England taking on a role as macroprudential regulator of the UK's financial system and becoming a powerful micro-level supervisor of financial institutions.

The Financial Services Act 2012 (FS Act) was the key piece of legislation that ratified the increase in central bank capabilities. It was brought before Parliament by the UK's coalition government, bring an end to the tripartite regulatory institutional arrangement. The Act granted the Bank enhanced micro and macroprudential regulatory capabilities, in addition to its existing monetary policy-making remit (Bank of England, 2013). It significantly altered the institutional architecture of the UK financial services regulation, creating the Financial Policy Committee (FPC), Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA) (the later can also exercise a veto over FCA activity) (Bank of England, 2013). This chapter examines how and why regulatory authority became concentrated within the Bank.

This case study disaggregates the process into three games played out in multiple arenas. I argue that institutional change of the BoE's capabilities is the result of the outcome of two

games played out between the government and the central bank, within the constraints of the institutional context. These games are nested within a political context and institutional constraints, which has a bearing on the potential outcomes (P1). The two sequential bureaucratic games are played on macroprudential reform; and on micro-level supervisory reform. The implication of this is that the preferences of the players in the sequential bureaucratic games are, to an extent, reconfigured as a result of the outcome of the institutional constraints. This is modelled below.

Figure 10: *The ACI framework applied to UK post-crisis supervisory reform*



6.2 Preferences, Players & Pay-offs

The ACI framework requires identification of the set of interactions that are to be explained. This allows for identifying the actors that are actually involved, and whose choices will ultimately influence the outcome (Scharpf, 1997, p.43). Actors are assumed to be capable of purposeful choices among alternative courses of action (Scharpf, 1997, p.7). They are assumed rational in the sense that they will attempt to maximize their own self-interest; but

they are not assumed to be perfectly rational. The issue of banking regulatory architecture is mainly of interest to the financial community, government, political parties and consumer groups. The financial crisis constituted an exogenous shock, triggering a dramatic shift in regulatory preferences. This section outlines the preferences of the key actors at the outset of the financial crisis and supervisory reform process.

6.2.1 Financial Industry lobby

Much has been written about the power of the banking lobby in achieving its regulatory preferences. Historically the UK government has been responsive to the views of the banking industry (Langdon, 1961, p. 527). However, in relation to the idea of empowering the BoE and regulatory venue change, the issue was not a top lobbying priority for the UK's banking sector (Llewellyn D. , 2004). Commercial banks were engaged and consulted throughout, but chose not to resist government or opposition proposals on the architecture despite not necessarily agreeing with them. The banking sector at this stage of the crisis was too weak to effectively resist institutional change and chose to save its political capital for future battles on substantive policy issues such as leverage and capital (HMT, 2010, p. 3) (Rawlings R. , Bank Reform in the UK Part 2: Return to the dark ages?, 2011a, p. 11). As one private banker stated:

> *"I don't think it was our place to go about lobbying anyone to do one thing or the other [on the architecture]. We accepted the logic of the need for change from a political perspective – so there was no argument from us there"* (Interview9, 2014).

Interviewees that participated in this study, both financial industry and non-industry, denied that the financial industry had a strong preference over the institutional architecture (Interview12, 2014) (Interview10, 2014) (Interview4, 2014).

Instead, commercial banks were concerned with assessing their own risk exposures and returning to a situation of market stability at this stage of the crisis cycle. The institutional configuration was of second order importance to them (Llewellyn D. , 2004) (Llewellyn, 2009).

6.2.2 Political parties

Historically political parties in the UK since the mid-90s have been cheerleaders for financial deregulation. But the crisis exposed the vulnerability of the UK economy to a financial system that had become 'too big to save', resulting in politicians re-evaluating their preferences.

The commitment to disband the FSA and empower the Bank was included in the Conservative Party's 2010 general election manifesto (Conservative Party, 2010, p. 29). This was some two years after the initial signs of disruption to the global financial system, which occurred in August 2007. The manifesto stated:

> *"We will abolish Gordon Brown's failed tripartite system of regulation and put the Bank of England in charge of prudential supervision. We will restore the Bank's historic role in monitoring the overall growth of credit and debt in the economy"* (Conservative Party, 2010, p. 29).

In contrast, the incumbent Labour government planed to provide further capabilities to the FSA in order to strengthen its regulatory capacity. It proposed the creation of a new institution as the guardian of financial stability – the Council for Financial Stability (Labour Party, 2010, p. 15) (Spiegel, 2008). This would consist of HM Treasury, the Bank and FSA. The Labour government's plan was laid out in the HM Treasury White Paper entitled *'Reforming Financial Markets'*, published in July 2009 (Treanor, 2009). It was widely

perceived as an attempt to kill off any attempt to abolish the FSA, given the criticism the FSA was receiving across the media and in Treasury Committee reports by 2010 (Treanor, 2009) (Interview14, 2015) (Interview15, 2015). Labour would have placed the state, via the Chancellor, at the heart of all decision-making. It also wanted to ensure the Bank gave greater prominence to its financial stability objective. This was not achieved through elevating the Bank to the position of lead macro or micro prudential regulator. The FSA retained micro prudential capability and would receive macroprudential powers. The Bank was instead provided with a primary statutory obligation to have regard for financial stability. This, if enacted, would have force the Bank and FSA to work more closely together and give the Chancellor a greater say in when its LOLR function is exercised. The Labour response represented an HM Treasury view on the problems it faced during the banking crisis. HM Treasury officials and ministers were extremely frustrated that they did not have any levers of control over the Bank (Treasury Committee, 2011, p. 13)(Darling, 2011) (Interview5, 2014) (Interview20, 2015) (Interview14, 2015). The formation of the Tripartite Council for Financial Stability also responds to Treasury Select Committee investigations into the crisis – which criticised the lack of communication amongst the tripartite membership.

The Liberal Democrats, like Labour, were committed to keeping the FSA and creating a Council for Financial Stability (Liberal Democrats, 2010, p. 15). However, the Liberal Democrats' strongest preference was for structural reform of the UK banking sector, as evidenced by its prominent position in its Treasury Spokesperson, Vince Cable's, speeches throughout 2009 and 2010 (BBC, 2009) (Rawlings R. , Part I – The Future of Banking Commission, 2011b, p. 4). In addition, Cable was also a commissioner on the consumer group-led 'Future of Banking' inquiry, which also backed structural reform (Which?, 2010).[17]

[17] Structural reform refers to the idea of splitting retail and investment banks into entirely separate and independent entities.

The table below summaries the banking supervisory reform options of the three major political parties that could have formed a government after the 2010 general election. These preferences are important, as they represent the only political constraints on institutional reform.

Table 9: UK political preferences on institutional reform

	Abolish FSA & transfer power to Bank of England	**Empower FSA & increase state control**	**Structural reform of banking sector**
Conservative	☐	☐	☐
Labour	☐	☐	☐
Liberal Democrat	☐	☐	☐

The Conservative Party's preference for empowering the Bank of England was the idea that was implemented. The common assumption is that it was implemented because the Conservative Party was the senior partner in a coalition government in 2010. This does not provide a satisfactory answer as to where these preferences derive from, nor how the Conservative Party came to a consensus on central bank reform with its coalition partner, the Liberal Democrats. Furthermore, it does not explain why the final institutional outcome differs from that envisaged by the Conservative manifesto. The decision to empower the Bank appears to be a suboptimal outcome for the Liberal Democrats, as they abandoned their own plans for reform of the regulatory architecture. Nor do the political party

preferences allow us to observe what role the Bank of England played in influencing the architecture of the reforms throughout its negotiations with the HM Treasury (its principal).

The strongly held supervisory reform preferences of both Labour and the Conservatives can be traced back to 1997 when Labour granted the Bank independence whilst simultaneously stripping it of supervisory capability (Quaglia, 2008b, p. 20) (Interview4, 2014). The rationale for making the Bank independent was two-fold – and incorporates both economic rationale and political gain. First, for many years Labour had watched in opposition as successive Conservative chancellors manipulated interest rates in election years. Increasing central bank autonomy in monetary policy-making prevented this happening in the future whilst also dealing with a potential credibility problem for Labour in terms of economic stewardship (King M. , 2005, p. 108) (Goodhart, 2002, p. 194) (Quaglia, 2008b, p. 21) (Balls, 1992).

Furthermore, pre-1997 Labour was concerned about its lack of support amongst the financial community in the City of London pre-1997. The financial community has traditionally been close to the Conservative Party (Quaglia, 2008b, p. 42). Labour wanted to build its credibility amongst the financial community and had found it extremely challenging to infiltrate this Conservative sphere of influence pre-1997. Instead, Labour adopted a different strategic approach and courted US banks that wanted access to the UK and EU markets (Rawnsley, 2010, pp. 477-78). London was an ideal home for them, however these American firms were deeply disconcerted by the lack of regulatory transparency and accountability that surrounded the City and Bank's supervisory capabilities in this pre-1997 era (Quaglia, 2008b, pp. 42-45). In addition, the Bank had suffered a number of high profile supervisory mistakes.[18] Hence Labour stripped the Bank of its supervisory capabilities,

[18] Including the BCCI fraud and the collapse of Bearings Bank in the 1990s.

ending the Bank's closeness to the living-banking sector. The Bank's supervisory capabilities were exported to the FSA. A new agency regulator located in one of London's poorest boroughs. The result saw US firms move to this new regulatory locus at Canary Wharf (Rawnsley, 2010, p. 478). Once the 2007/08 crisis hit, and with an election due, Labour's strategic calculus was to ensure the system it created remained in place. To abolish the tripartite system in the face of an election would have been an admission of failure and responsibility for the extent of the crisis. Thus it opted to strengthen its own institutions in an attempt to signal to the electorate that it could prevent future bank bailouts.

There are two explanations for Conservative preferences on institutional change. First, the Conservative desire to abolish the FSA and empower the Bank was rooted in perceptions of agency failure. The Conservatives blamed the FSA for not spotting the signs of the financial crisis. Transferring its supervisory powers to the Bank would lead to more efficient rule making: it would strengthen regulation because it would be less prone to industry capture (Conservative Party, 2009). Yet this functionalist account only provides a partial, and arguably misleading, picture of Conservative party preferences. Fundamentally, it ignores the importance of politics in shaping political preferences. Political competition accounts of delegation would stress that the Conservative desire to scrap the FSA was motivated in large part by a desire to make a symbolic break from the past and to engage in 'blame shifting': to apportion the blame for regulatory failure on their political opponents who established the existing supervisory architecture. But the party's preferences were also path dependent to the extent that they were shaped by past institutional choices. As previously mentioned, historically the Conservatives had strong links with the City of London and the BoE was an important part of its political network (Moran 1991). By contrast the FSA was viewed as an institution of New Labour (Interview16, 2015) (Interview13, 2015) (Interview5, 2014). The Conservatives opposed its creation in 1997 because it potentially allowed the new

government to expand its own sphere of influence in the City by establishing a new source of institutional support and patronage (Interview1, 2014) (Interview2, 2014) (Interview3, 2014).

The Liberal Democrats had supported Labour's establishment of the FSA in 1997 and thus sought limited institutional alteration.

6.2.3 Bank of England

The Bank is a non-partisan independent bureaucratic institution. The Bank's overriding preference was to protect its LOLR and monetary policy autonomy (Quaglia, 2008b, p. 42) (Interview13, 2015). The Bank also harboured a strong preference to remain divorced from day-to-day micro supervision (Bank of England, 2007) (Quaglia, 2008b, p. 42) (Keegan, 2010) (Interview6, 2014) (Interview13, 2015) (Treasury Select Committee, 2011, p. 124). Its Governor viewed this supervisory and enforcement work as beneath a modern era monetary policy-making focused central bank (Interview13, 2015) (Interview2, 2014).

When considering the Bank's preferences, the simplifying assumption used is that its preferences are heavily influenced those of its then governor, Mervyn King (Treasury Select Committee, 2011, p. 111) (Interview13, 2015) (Interview15, 2015) (Interview14, 2015) (Giles, The Court of Mervyn, 2012a) (Conaghan, 2012). King was very much on board with the changes introduced to the Bank in 1997, divorcing the BoE from day-to-day supervision of the banking sector (Interview6, 2014) (Interview3, 2014) (Interview13, 2015). He was a well-respected deputy governor at this time and identified as a potential future governor. In addition, throughout the Bank-led interventions in BCCI and Bearings, King had been vocal in his disapproval at the Bank's interventions (Interview6, 2014) (Interview13, 2015). His preference was that a modern central bank should be solely focused on independent

monetary policy-making and not the guardian of the living-banking sector (Interview13, 2015) (Interview2, 2014) (Interview20, 2015) (Interview6, 2014).

6.3 A Financial crisis, 2010 general election & re-shaping actor preferences (Sept 2007 – May 2010)

The ACI framework recognises that the socio-economic context constitutes an important exogenous source of change which can (re-)shape the nature of P-A games. One mechanism through which this may occur is in response to economic crises, which alter the electoral incentives facing political parties. In response political actors in the institutional reform process will adjust their preferences and strategies in order to maximise the electoral payoff they anticipate from voters.

The collapse of Northern Rock on 14th September 2007 marked the start of the financial crisis on British soil. Soon after the fiscal burden of bailing out two of the UK's largest banks sent shockwaves through the political establishment. This led the three main parties to conclude that the existing regulatory system was fundamentally broken and that banking supervision – at both the macro and micro level – had to be significantly strengthened in some form.

As the crisis intensified so did the discrediting of New Labour's economic and regulatory policies – in particular in the remit of banking regulation. At the time of the Northern Rock nationalisation George Osborne, Shadow Chancellor, used the event to discredit the economic competence of the incumbent Labour government. The Conservative strategy became one of criticism of Labour action without having to put forward its own crisis management strategy. Osborne stated:

> *"This is the day when Labour's reputation for economic competence died. Gordon Brown has dithered his way to the disaster of nationalisation. We will not back nationalisation. We will not let Gordon Brown take this country back to the 1970s"* (Burns & Parker, 2008).

Given the intensity and prolonged nature of the financial crisis the topic unsurprisingly became the background narrative for the election campaign, forcing political parties to generate ideas and new preferences on regulatory arrangements. Banking regulation, throughout the crisis, moved from one of low salience to high salience. Parliament conducted a series of high-profile reports into the crisis, which tarnished the FSA in particular, and thus aided this transformation from low to high salience (Treasury Commitee, 2008) (Treasury Committee, 2009) (House of Lords Select Committee on Economic Affairs, 2008). The literature on the politics of crisis management suggests, following a crisis there is a witch-hunt to find and hold to account those individuals or institutions deemed responsible (Brändström & Kuipers, 2003) (Drennan & McConnell, 2007) (Boin, McConnell, & 't Hart, 2008). Hindmoor and McConnell suggest this crisis has resulted in a witch-hunt process around the globe (Hindmoor & McConnell, 2014, p. 2). This in turn made supervisory institutional arrangements difficult for elected officials to ignore. The media began initially isolating the key players – politicians, bankers and regulators – and apportioning criticism. This in turn led to the public being able to question the legitimacy and competency of regulatory agencies as well as the banking sector; with an election due imminently politicians sought to act so as to protect their re-election prospects.

This process of blame attribution began with the Treasury Committee (TC) undertaking hearings and publishing a sensationally entitled report into the failure of Northern Rock, The *Run on the Rock* (Treasury Commitee, 2008). Throughout its investigations the TC was *"in a*

particularly combative mood and never more conscious that the media were hanging on their every word" (Conaghan, 2012, p. 151). The TC hearings into the run on Northern Rock and the mortgage market dysfunction criticised all tripartite members (Treasury Commitee, 2008, p. 44). However, the most severe criticism was reserved for the FSA, with TC chair, John McFall MP, commenting that the FSA was guilty of a *"systemic failure of duty"* (TSC, 2008, p. 35) (BBC, 2008). This line was repeated in the TC final report and dominated media headlines.

The TC published its final report in early 2008 (Treasury Commitee, 2008, pp. 35-39). Both the hearings and the final report laid bare the extent of the disagreements between the tripartite authorities – extracts of which were widely covered by the print and broadcast media (BBC, 2008) (Politics.co.uk, 2008a) (This is money, 2008) (Mirror, 2008) (Brown C. , 2008). The TC report also made some recommendations for improvements to the tripartite system, though crucially the TC was explicit in not issuing a call for institutional abolition (Treasury Commitee, 2008, p. 117). The Report instead identified the FSA supervisory culture as one of micro prudential regulation and also drew attention to a gap existing where macroprudential regulation should have taken place.

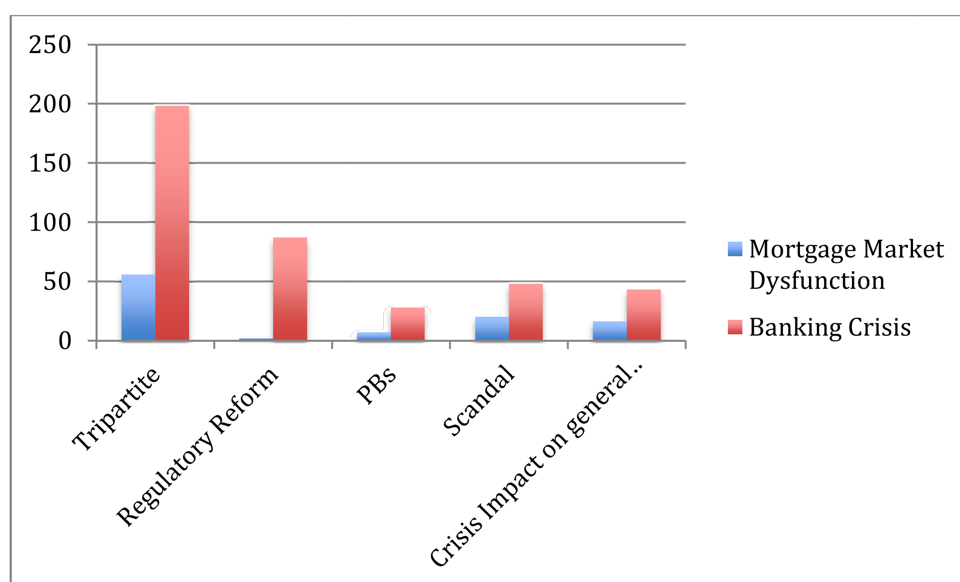
The idea of macroprudential regulation was championed in the UK by FSA chair, Lord Turner (Baker, 2013) (Sibun, 2009). Turner had been convinced of the need for macroprudential capabilities through attending these meetings (Baker, 2013). Turner became an advocate at the Financial Stability Forum (FSF), and authored the Turner Review – which expounded the virtues of a macroprudential approach (Baker, 2013). The Financial Stability Board (FSB) had prepared reports for G20 meetings, which contained references to '*mitigating pro-cyclicality'* for the first time in the Horsham communiqué of 2009 (G20, 2009) (Baker, 2013). Turner continued to make the case to HM Treasury, the Bank of England, minsters and the

TSC (Baker, 2013). Throughout the period of Autumn 2007 through to the end of Spring 2009 – that the idea gained further traction in the UK (Baker, 2013) (Interview13, 2015) (Interview14, 2015) (Interview5, 2014). The argument accepted was '*we need to use regulatory policy for macroeconomic purposes and we should have some sort regulator to increase capital requirements in booms and so on'* (Interview13, 2015). The power of macroprudential ideas won the minds of policy-makers across party lines. This victory is reflected in the judgements of the TC.

The impact of the TC's hearings and reports throughout the crisis aided the perception of regulatory failure to dominate media headlines. Institutional reform was not something political and bureaucratic elites could ignore. This is not to say that the public demanded the abolition of the FSA or central bank empowerment, but rather that the issue of effective supervision and regulation on banks became high salience as evidenced in the figure below.

Figure 11 highlights the salience of the Tripartite arrangements from the outbreak of the crisis through to the 2010 general election. The table shows the number of major UK papers that ran articles related to different facets of the crisis. The majority of articles focused on institutional arrangements.

Figure 11: Number of major UK newspaper articles relating to the crisis stages (2007-2010).



Although historically a cheerleader for financial deregulation, the crisis exposed the unique vulnerability of the UK economy to a financial system that had become *'too big to save'*. The first run on a bank in 100 years, combined with the fiscal burden of bailing out two of the UK's largest banks, sent shockwaves through the political establishment. There was an increase in media attention on apportioning blame for the crisis. This led both main parties to conclude that the existing regulatory system was fundamentally broken and that banking supervision – at both the macro and micro level – had to be significantly strengthened.

During the intense fire-fighting phase of the crisis (2007-early 2009) the preferences of political actors were ill defined. Consequently the BoE was slow to respond to this radically altered political context and calls for institutional reform. Its overriding preference was to protect its narrow monetary policy mandate and defend its hard fought credibility on maintaining price stability which had defined Mervyn King's tenure. The Bank therefore, initially, sought to resist any expansion of its mandate to include either macro prudential regulation or micro supervision (Interview6, 2014) (Interview5, 2014) (Interview13, 2015)

(Interview15, 2015) (Interview14, 2015). This was despite the fact the epistemic community had largely agreed that central banks should take on this new macroprudential responsibility (Borio, Implementing the macroprudential approach to financial regulation and supervision, 2009) (Blanchflower, 2009) (Interview13, 2015).

However, the Bank initially did not want macroprudential capabilities. There was a group of people within the Bank, including several of the external MPC members, who thought it should be the responsibility of HM Treasury to discharge macroprudential regulation (Interview13, 2015) (Interview20, 2015) (Interview5, 2014) (Interview6, 2014). This group within the Bank believed macroprudential regulation was a government function not a central bank function – they were worried about overloading the Bank (Interview20, 2015) (Interview5, 2014) (Interview6, 2014). It was not until late 2008 that the Bank reassessed how it would need to alter its preferences to maximise its utility (Bank of England, 2008, pp. 198-200). The Bank's altered preference was now to claim macroprudential regulation for itself and leave micro prudential regulation in the hands of the FSA (Interview13, 2015) (Interview6, 2014). Senior Bank officials now argued that the Bank should have the capacity to direct the micro-level supervisor on the basis of the Bank's macro-economic analysis (Northedge, 2009) (Interview13, 2015) (Interview14, 2015) (Interview15, 2015) (Interview19, 2015) (Bank of England, 2008, p. 199). From initially believing that a financial stability objective was unlikely to have parallels with the Bank's monetary policy responsibilities, the Bank came to view monetary and macroprudential policy as intrinsically linked and essential to underpinning its future autonomy (Interview19, 2015) (Bank of England, 2009). Instead the Bank wanted the express power to give direction to the FSA (Bank of England, 2009). How can we explain this change?

The Turner Review, publicised in 2009, presented a number of options to improve the regulatory structure of the UK authorities. Not one of these options, unsurprisingly given Turner's role as FSA chair, suggested the abolition of the agency regulator and providing the Bank of England with enhanced supervisory capabilities. Turner recommended to the Chancellor that a Financial Stability Committee, made up of both FSA and Bank personnel, be jointly responsible for macroprudential risk judgements as well as directing regulatory responses to deal with the identified risk (Turner, 2009, p. 84). The Turner Review was a blueprint to ensure the relevance of the FSA in the future of UK banking regulation by redefining its relationship amongst the existing tripartite membership (Interview2, 2014) (Interview3, 2014).

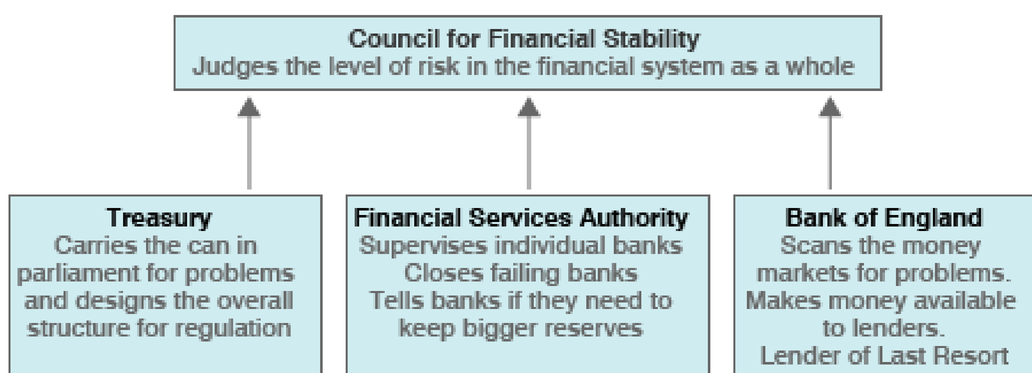
In response to the Turner Review the Bank began discussing the formal capabilities it would want in relation to macroprudential regulation on 12 March 2008 (Bank of England, 2009). This was done under the agenda item of 'Financial Stability and Depositor Protection', and led by the Governor and Bank Secretary, John Footman (Bank of England, 2009, p. 192). The discussion that followed amongst the Bank's most senior leaders is illuminating in revealing the Bank's preference for institutional reform. The Bank's senior leaders expressed serious concerns about taking on financial stability capabilities. Bank Court minutes note that the Bank would be unable to avoid all aspects of financial stability work, but 'a*nything that compromised the Bank's commitment to monetary stability would be a high cost to bear';* the Bank should consider requesting empowered to give directions to the FSA*;* and that the Bank would not wish to have no involvement in assessing institutions solvency if it would be expected to provide LOLR financing (Bank of England, 2009, p. 199). The minutes also note that there may be sensitivities between the Bank and FSA preferences, thus further discussion should be conducted in the absence of FSA senior officials (Bank of England, 2009, pp. 199-200).

The Turner Review directly informed the Banking Act 2009 (Hall, 2009, p. 37). The 2009 Banking Act empowered the Bank by formally providing it with a statutory responsibility for financial stability, whilst maintaining the tripartite institutional arrangement (BBC, 2009) (HM Government, 2009, p. 122) (Darling, 2011, p. 254) (Bank of England, 2009, p. 198). This attention to financial stability was an aspect of work that HMT and the FSA felt the BoE had not paid due attention to in the build-up to the crisis.

In addition, further details of the 2009 Banking Bill were published in an HM Treasury White Paper on July 8th 2009 (HM Treasury, 2009). The White Paper received royal assent on 9 April 2010, becoming the Financial Services Act 2010. The government lost power on May 6th 2010. None the less given the statutory power of a legislative Bill, it became the new institutional arrangement. The 2010 Act made changes to the way the tripartite coordinated responses by placing the Chancellor at the heart of a new Council for Financial Stability in line with the recommendations of the Turner Review (Hall, 2009, p. 38). It is worth noting that the Turner Review, in terms of its macroprudential idea, was based upon the work of the Bank of International Settlements (Borio, 2009) (Borio, 2011). The terms of reference for the Council replaced the tripartite Memorandum of Understanding – not updated since 2006. The creation of the Council placed the state, via HMT, at the heart of financial stability decision-making and ensured the tripartite remained in place with the appearance of solving the criticisms that had been levelled at it since the crisis outbreak (Interview3, 2014) (Interview2, 2014) (Interview4, 2014). The Act provided the FSA with additional policy tools as the joint-guardian of macroprudential as well as micro prudential regulation, giving it a statutory objective for financial stability alongside the Bank (Rawlings R. , Bank Reform in the UK Part 2: Return to the dark ages?, 2011a, p. 4). Labour's strategy was to focus on strengthening the institutions it had created as a response to the on-going criticism of

institutional arrangements from the Conservative party. The Labour plan was the preference of HM Treasury officials, who had been frustrated at the lack of capabilities HM Treasury possessed to control the Bank during a crisis period (Interview5, 2014) (Interview20, 2015). The Treasury found it had few levers to pull and was at the mercy of Bank decision-making when bailouts were required and could not override the Bank's refusal to lend to the banking system at low penal rates (Chambers, 2010) (Llewellyn D. T., 2009) (Interview20, 2015).

Figure 12: Labour tripartite post-crisis reform architecture (adapted from the Turner Review)



Senior Bank officials interpreted the 2009 White paper as a signal, and adapted the Bank's strategic approach to protect its autonomy. The Bank made an important decision – if it was to be held responsible for financial stability it would need all the policy-making powers to accompany this new statutory objective (Bank of England, 2008, p. 199) (Interview13, 2015) (Interview6, 2014) (Interview21, 2015). Labour supported the expansion in FSA regulatory analysis to cover macroprudential risks, with the Bank as a member of the new Financial Stability Council (HM Treasury, 2009, p. 57). Senior Bank officials viewed relying on FSA analysis as a direct threat to its LOLR autonomy and wanted sole discretion in macroprudential policymaking (Interview13, 2015) (Interview6, 2014) (Interview21, 2015)

(BBC News, 2009). It remained the case that the Bank wanted no direct responsibility for micro prudential regulation of the living-banking sector at this juncture.

This preference re-configuration led to the Bank openly requesting the power to intervene when it judged financial stability was at risk throughout 2009 – for example the power to compel the banking sector to increase its capital buffers, liquidity and leverage (King, 2009). The Bank had come to the conclusion, after the Labour government's preferences were revealed, that if macroprudential regulation of the economy was a capability one member of the tripartite had to take on, it was better that the Bank be responsible for it than any other institution (Interview6, 2014) (Interview13, 2015) (Giles, 2009).

This bureaucratic rivalry for macroprudential authority led to competition between the FSA and Bank (Hall, 2009, p. 5) (Masters & Parker, 2008) (Interview21, 2015) (Interview22, 2015). This gave the Bank's preference change additional impetus and forced it to rethink its long held preference for a narrow monetary policy mandate.

The Bank's strategy to pursue its preference change led to an intervention that saw it attempt to influence the wider political context. The Governor openly criticised the Labour Chancellor's institutional reforms at his 2009 Mansion House speech (King, 2009). It is the highest-profile speech of the year for key UK-based financial figures and used to float their greatest ideas (Irwin, 2013, p. 232). The Bank believed it had been placed in a position of formal responsibility for financial stability, but little power to influence it beyond its own spoken and written words (Bank of England, 2009, p. 434) (King M. , 2009) (Interview6, 2014) (Interview13, 2015). During the speech King stated:

"…it is not entirely clear how the Bank will be able to discharge its new [financial stability] statutory responsibility if we can do no more than issue sermons or organise burials." (King M. , 2009).

The Bank's public condemnation of its principal's preference had the impact of signalling to opposition parties. The Bank's strategy in this instance was not to make a pitch for the micro-level supervision of the banking sector to protect its LOLR capability, but rather to seek the power to be able to direct the micro-level supervisor, on the basis of the Bank's macro-economic analysis, in order to preserve the independence of the Bank's most prestigious policy-making capability – the MPC (Bank of England, 2009, pp. 433-34) (Bank of England, 2008) (Northedge, 2009) (Interview13, 2015) (Interview14, 2015) (Interview15, 2015) (Interview19, 2015). The Bank came to view monetary and macroprudential policy-making as intrinsically linked in the post-crisis orthodoxy (Interview19, 2015). This was a marked change in ideological paradigm compared to pre-crisis beliefs. This change, in part reflects the diffusion of ideas on macroprudential policy from the Basel network.

A post-bank bailout surge in support for the Conservative Party gave the Bank a further, and potentially more fruitful, avenue of influence in which it could leverage its policy expertise to shape the regulatory future in accordance with its revised preferences. It was almost certain that the Conservative Party would be the largest group in the 2010 Parliament (Hall, 2009, p. 37) (Kettell & Kerr, 2008, p. 490) (Beckett, 2009). The trigger for the Bank's engagement with the Conservative plan was the 2009 European Parliament elections. Labour finished in third place whilst the Conservatives' won the popular vote (BBC, 2009). On the back of this strong performance, the Bank chose to engage with Conservative preferences for abolishing the FSA and empowering the central bank in supervisory terms (Conaghan, 2012, pp. 239-41) (Interview6, 2014) (Interview13, 2015).

Conservative opposition had heard the Bank's unhappiness with the Labour reforms (Giles, 2009). The result was the Shadow Treasury team meeting with the Bank Governor to outline its reform preferences (Conaghan, 2012). The Conservative team arrived at the Bank armed with a report authored by a former HM Treasury official, James Sassoon. The Shadow Chancellor, George Osborne MP, poached Sassoon very early after the collapse of Lehman Brothers (Interview5, 2014) (Interview13, 2015) (Interview3, 2014) (Eaglesham, 2009a) (Hall, 2009, p. 37). He was given the position of chairman of the Conservative Party's economic recovery committee and tasked with undertaking a review of banking regulation in the UK (Rawnsley, 2010, p. 477) (Sassoon, 2009) (Hall, 2009, p. 37).

The Sassoon report presented a number of options. However, on closer inspection these options all involved diminishing or abolishing the tripartite system and placing the Bank at the heart of micro and macroprudential regulation. Sassoon's options are outlined below:

- *"The FSA…should be reorganised with one part focusing on the "prudential" watchdog function and the other on conduct of business and The BoE should be given new powers to intervene in the reformed FSA if it believes that a failing institution is threatening overall market stability;*
- *The FSA should be abolished and replaced with two separate regulators, one for prudential micro-regulation (of institutions) and the other for conduct of business and the BoE should be handed powers to step in over the head of the new prudential micro-regulator in exceptional circumstances after the FSA has been split up; or*
- *The new micro-regulator of banks, or the whole financial sector, becomes part of the Bank of England"* (Pennington, 2009).

In July 2009 the Conservative Party published a policy White Paper, based upon the Sassoon report, which confirmed the Conservative's desire to abolish the FSA and transfer its capabilities across to the Bank (Osborne, 2009, p. 2). The White Paper indicated the Conservatives saw no role in micro prudential regulation of firms for a consumer protection agency (Conservative Party, 2009, pp. 14-16).

This White Paper was again far from completely aligned with the Bank's preferences (Hall, 2009, pp. 2-3). Following the meeting between the Bank and Conservative leadership It was clear to the Bank's hierarchy that the Conservative team wished to use institutional reform in order to make a clear political point over blame for the crisis (Wintour & Leigh, 2010). King infamously stated: *"Cameron and Osborne have a tendency to think about issues only in terms of politics and how they might affect Tory electorability"* (Wintour & Leigh, 2010). The Bank also expressed concerns that the new Conservative hierarchy was resistant to reaching out beyond their small inner circle for policy advice (Wintour & Leigh, 2010). Nonetheless, for the Bank, engagement was rational given how close the polls were in the run up to the 2010 general election.

The account detailed above points towards a preference formation grounded in political and bureaucratic competition. The incumbent Labour government sought to protect the institutional status quo so as to preserve its reputation in office; by contrast, the Conservative opposition sought to discredit the government by calling for institutional reform as a symbolic break with the past. Thus far this process is consistent with what would be expected under the political explanations for institutional reform. The altered political environment forced the Bank to reconsider its preferences in order to defend its independence from both government principals and a rival agency.

6.4 Bureaucratic Politics: Establishing players and pay-offs

The ACI framework suggests the institutional constraints serve as an exogenous source of change, when government principals themselves change. The 2010 General Election resulted in a hung parliament, with the Conservatives as the largest party but reliant on support from other parliamentary groups.

There followed a short period of negotiation between the Conservatives and the Liberal Democrats who held divergent positions on banking reform, before an official coalition government was formed. Although the subsequent division of ministerial posts ensured that the Conservatives would take lead responsibility for banking reform, the ministerial group through which decisions were made provided the Liberal Democrats with significant influence over the agenda. The Conservatives occupied the position of Prime Minister and First Lord of the Treasury; Chancellor of the Exchequer; and Financial Secretary to HM Treasury. The Liberal Democrats secured the posts of Deputy Prime Minister; and Chief Secretary to HM Treasury. This group of ministers, known as the *'quad',* discussed all policy positions to negotiate Coalition positions (Ganesh, 2014). The Coalition Agreement, reached on 13 May 2010, defined the broad contours of the political deal between the governing parties on banking reform. It contained two key commitments: first, the importance of reform of the tripartite supervisory system by abolishing the FSA and transferring most of its responsibilities to the Bank of England; and second, a commitment to establishing an independent commission to investigate the viability of structural reform in the banking industry (Gamble, 2012, p. 65) (HM Government, 2010, p. 9).

Table 10: Political preferences on supervision and structural reform

	Abolish FSA & transfer power to BoE	Empower FSA & increase state control	Structural reform of banking sector
Conservative	□	□	□
Liberal Democrat	□	□	□

The political agreement on banking reform is one that excluded the central bank due to the institutional constraints of the UK political system. Both coalition parties wielded veto power and the deal was non-binding. In other words, both parties must agree to the deal, and it must logically be in their interest to do so in order for agreement to be reached (Scharpf, 1997, p.7). This is because a parliamentary majority is required to pass legislation in the UK Westminster system. In order to achieve the majority in the coalition government the support of both parties was required to enact institutional reform. Moreover, the political agreement is self-enforcing as both parties retain the option of defection. This relies on a calculation of the reversion outcome; in other words, the implications of non-agreement (Baron 1991, p139) (Landman and Robinson 2009). I contend that subsequent defection from the political deal on banking reform would not have been a collapse of the coalition government, but simply a refusal on the part of the Liberal Democrats to support legislation on the institutional reform in Parliament. The reversion outcome is therefore the status quo; that is, the reinforced tripartite system of supervision passed in the final days of the last Labour government.

The costs of non-agreement would not be distributed evenly, however. Given the Conservative support for scrapping the existing tripartite supervisory system, and Liberal Democrat support for strengthening it, the status quo/non-agreement position represents a net gain to the Liberal Democrats and a clear loss to the Conservatives. This outcome was a stable Nash equilibrium because if the Lib Dems defect, the Conservatives cannot improve their payoff by also defecting as the outcome would still be non-agreement. By contrast, the commitment to scrapping the tripartite system in the Coalition Agreement represented a win for the Conservatives and a loss for the Liberal Democrats. This outcome would not be a stable Nash equilibrium because the one player – the Lib Dems - could improve their payoff from the deal by unilaterally defecting.

Viewed in isolation, the outcome on supervisory reform is suboptimal for the Liberal Democrats. How do we explain this? The political deal explicitly linked the commitment to supervisory reform to the pledge to create an independent commission to investigate banking reform (Peston, 2010) (Interview7, 2014) (Interview9, 2014) (Moran, Johal, & Williams, 2011, p. 115) (Parket, 2011). At the time this was politically expedient for both players: the Conservatives were able to put off a decision on structural reform for the foreseeable future, while the Liberal Dems secured a commitment that the issue would be seriously considered. The deal had the effect of widening the scope for political agreement and enabled the final outcome to shift to the area of mutual gain to both political actors. Viewing the distribution of costs and benefits across both issues, the overall political deal was optimal for both parties because it yielded a net gain for each (BBC News, 2010). In doing so, the Conservatives were able to secure the support of the Liberal Democrats for the overall package of institutional reform (Interview5, 2014) (Interview19, 2015) (Interview18, 2015) (Interview12, 2014) (Interview11, 2014) (BBC News, 2010).

To summarise, the Conservatives and Liberal Dems shared a commitment to reconfiguring banking regulation. Yet they differed fundamentally over the design of the control mechanisms needed to achieve this (Chambers, 2010). The Conservatives wanted to abolish the FSA and create a new FPC with HM Treasury control; while the Liberal Democrats wanted to maintain the existing tripartite system, but overlay it with a powerful Council of Financial Stability, chaired by the Chancellor. The political deal resolved the issue decisively in favour of former. This political deal between the coalition parties determined the parameters of acceptable outcomes for sequential bureaucratic games with the BoE. In short, it defines the broad contours of subsequent negotiated agreements between bureaucratic actors in two ways. It imposes the shadow of political hierarchy, which ensures that bureaucratic agreements are binding on actors, and prevents bureaucratic actors from subsequently defecting too substantially. The status quo is no longer within the range of possibilities following completion of the coalition deal. The institutional constraints of the UK system are such the this agreement was all that was required in order to secure the parliamentary majority for institutional reform to pass through the legislative system. The strong party system in the UK means that the likelihood of defection by individual MPs of the ruling parties is relatively low, as their career progression is tied directly to how party leaders view them. Added to this, the Liberal Democrats had not held governmental positions since the wartime coalition; whilst the Conservatives had been locked out of government since 1997. Neither party's MPs were going to risk intra-party cleavages so soon into the life of the government. The coalition partners each believed that the electorate would reward ownership of far-reaching regulatory institutional reforms, in the wake of the worst crisis in living memory, in the near future. This is evident in the manner in which both party's sought credit for the distinct aspects of the institutional reform: the Conservatives for abolition of the FSA; the Liberal Democrats for an independent commission on structural reform.

6.5 Bureaucratic Negotiations: Lower order bureaucratic politics

The conclusion of the coalition agreement resulted in a sequential negotiation between the BoE and HM Treasury. HM Treasury is the government department with responsibility for turning the outcomes of the political deal into legislative reality. As such HM Treasury led day-to-day negotiations with the Bank and the FSA. By this point, as a result of the coalition agreement the FSA had accepted the reality of abolition. The FSA recognised that the institutional constraints it was faced with were insurmountable following the coalition agreement. The FSA could no longer rely on the support of Labour, or other political parties, to overcome the majority in the House of Commons. Its previous ally, the Liberal Democrats, had altered its preference following election. The House of Lords, as a principle, will only use its veto power to block significant constitutional change and, even then, only if it believes there was no popular mandate for the change. It was extremely difficult to argue public opinion did not want the crisis to be addressed in some manner. Thus the FSA could not lobby the upper chamber effectively in this instance.

The remainder of this chapter uses the ACI approach to model a negotiation between HM Treasury (the government principal) and the BoE (the agent). The negotiations are disaggregated across two policy areas: macroprudential supervisory reform; and micro-supervisory reform. Once institutional reforms are enshrined in legislation, the bureaucratic actors cannot unilaterally defect. The rules of the game, defined by the mode of interaction between HM Treasury and the Bank, can however take one of two forms (Scharpf 1997). First, under hierarchical direction, agreement may simply be imposed unilaterally on the agent by the principal. This means that outcomes may be highly suboptimal from the central bank's perspective because its preferences can effectively be ignored as governing parties pursue electoral interests. It therefore renders the scope for institutional reform to be far-reaching in theory. If the political explanation holds true this is the outcome that

would be expected. Second, an institutional outcome may be found through negotiated agreement. In this negotiation, both actors effectively wield veto power, so both players must reach agreement on institutional reform consensually. It follows that the scope for change is much lower under this mode of interaction and that the final outcome cannot be sub-optimal for the central bank.

The resolution of these games point towards the process of reconfiguring delegation not being a hierarchical one in which the principal can impose institutional reform on subservient agents; but rather one involving a prolonged process of bargaining and negotiation leading to a mutually acceptable agreement. This mode of interaction provided the Bank with effective veto power, allowing it to narrow the scope of institutional reform and shift the outcome back towards its own preferences. In the absence of effective Bank influence, I would expect the outcome of the institutional reform to mirror the preferences of the Conservative Party as outlined in the Conservative White paper published in 2009.

The broad contours of institutional reform set out by the Coalition Agreement were sufficiently vague, leaving considerable discretion to just two bureaucratic actors to hammer out the final terms of agreement. This enabled the Bank to pursue a bureau-shaping strategy of agency *'subversion'*: maximising its autonomy over desirable policy functions, while delegating undesirable functions to subordinate agencies. It did so by exploiting its influence over HM Treasury, leveraging its expertise, across the macroprudential and micro prudential reform negotiations. This allowed it to leverage its influence and secure a more favourable outcome. Hence the final outcome of institutional reform is closer to the Bank's preferences, and significantly different from what the government had originally proposed. The following analysis provides the evidence for this claim.

6.5.1 Macroprudential Supervisory Reform

This first disaggregated negotiation concerns the location of macroprudential supervision. The result of the Coalition Agreement appeared to have shifted the institutional reform towards the Bank's preferences and away from that of the previous Labour government. At first glance this would allow the Conservatives to highlight a clean break from the regulatory policies of the past and satisfy senior Bank officials. As the negotiation began, notable differences between the government and Bank began to emerge. These differences centred on the degree of policy discretion delegated to the Bank and the nature of principal control mechanisms. HM Treasury's ideas for institutional re-design altered the pay-offs for the Bank and thus the two actors entered into a period of lengthy negotiation.

New Conservative Chancellor, George Osborne MP, used his first Mansion House Speech, in June 2010, to confirm his intention to abolish the FSA. This event is significant because it signalled the beginning of a formal legislative process and a negotiation between the government and Bank. The new Conservative Chancellor stated:

> *"Despite the changes that have been made, I am still not confident that the fundamental problems of…regulatory structure have been confronted"* (Osborne, 2010).

In the speech the Chancellor confirmed his manifesto commitment to transfer supervisory power to the Bank and provide it with a new remit to *"prevent the build-up of risk in the financial system in addition to its monetary policy role"* (Masters & Parker, 2010). The speech confirmed the creation of the FPC as a committee of the Bank that would be charged with addressing issues that *"threaten economic and financial stability"* (Osborne, 2010). The new Chancellor stated that only a central bank had the expertise and knowledge to make the judgements that are required for economic stability (Osborne, 2010). Crucially in the

speech Osborne pointed to the Bank taking on all prudential regulation and the creation of a new agency that would only deal with consumer protection. The new government, dominated by the Conservatives, was still seeking a symbolic break with the Labour institutional set-up.

Although by this point fully committed and converted to central bank-led macroprudential regulation, the Bank harboured concerns about precisely what form this institutional reform would take. Above all it feared that it might compromise its monetary policy capabilities, and the political independence granted to it via the 1997 reforms, which were considered sacrosanct (Barty, 2012, p. 39) (Interview6, 2014) (Interview13, 2015). Bank Court minutes from earlier in the crisis note:

> *'Anything that compromised the Bank's commitment to monetary stability would be a high cost to bear'* (Bank of England, 2008, p. 199).

These concerns were rooted in the logic of delegation. For monetary policy, government delegates control of interest rates to central banks to solve commitment problems; namely, to signal it's pre-commitment to specific policy outcomes – such as low inflation. Delegation is therefore high, while ex ante/post controls are low to maximise political credibility. By contrast, delegation of macroprudential regulation is driven less by commitment and the need to *'lock in'* policies because the desirability of particular policy outcomes is less clear. Instead it frequently involves making difficult trade-offs between competing policy objectives, such as maintaining international competitiveness and financial stability at home. Delegation is therefore more likely to be motivated by the desire for efficient rule making, blame shifting, or political pay-offs. In this context, government principals will seek to retain the power to define policy objectives over time as their preferences change: consequently ex ante delegation will be lower, while ex post controls will be greater.

The Bank's fears over political control by government for electoral gains were confirmed when HM Treasury advised government that its ideal preference was to create a new FPC, chaired by the Chancellor, providing an ex ante control mechanism that was lacking throughout the crisis (Interview20, 2015) (Interview5, 2014). HM Treasury was keen to ensure that it would have the final word given that taxpayers would ultimately bear the brunt of macroprudential regulatory failure (Interview5, 2014) (Interview20, 2015). This was a direct response to the issues experienced during the financial crisis and HM Treasury's earlier interactions with the Bank on resolution of Northern Rock and the special liquidity scheme a year later (Darling, 2011, p. 23). HM Treasury had been actively looking for ways to force the independent central bank's hand since the outbreak of the crisis (Darling, 2011, p. 23) (Interview5, 2014) (Interview20, 2015) (Interview2, 2014). In response, the Bank believed it had little choice but to fight to preserve its autonomy by maximising the delegation of new powers and minimising ex ante control mechanisms. Its strategy involved lobbying for an institutional design for macroprudential regulation mirroring that which existed for monetary policy, based on ex post accountability. Specifically, the Bank proposed that the new FPC be modelled on the Monetary Policy Committee (MPC), with the Bank Governor as Chair (Reece, 2012). This was viewed as the best guarantor of the Bank's continued political independence (Interview19, 2015) (Interview13, 2015) (Interview6, 2014) (Interview20, 2015) (Reece, 2012).

Given the Bank's pre-election interaction with the Conservative Party, it had allowed itself sufficient time to strengthen its analytical arguments and develop a strategy to bring the reforms closer to the Bank's preferences (Interview6, 2014) (Interview13, 2015). This time allowed the Bank to make a series of technical and political arguments during the

negotiation. The Bank was able to assess the preferences of the Conservative party and counter them with its technical expertise to influence the eventual outcome.

As a starting point the Bank argued that there were two missing gaps in the pre-crisis orthodoxy as it sought to wrestle macro-economic decision-making away from the FSA – where the previous Labour government had placed the responsibility pre May-2010 – and HM Treasury's authority. First, there was a lack of macroprudential regulation. Second, a lack of a macroprudential policy toolkit to safeguard the entire financial system. These were aspects identified by the Bank of International Settlements and discussed in a number of academic papers (Bank of England, 2011) (Bank of England, 2013) (Borio, 2011) (Borio, 2009) (Turner, 2009). In this aspect, the Bank was drawing on the work of a group of regulatory experts, but utilising this work in order to privately lobby HM Treasury. The Bank pushed heavily for the policy-making power but resisted the micro-supervisory capabilities (Interview6, 2014) (Interview13, 2015) (Interview15, 2015) (Interview16, 2015). Bank officials highlighted to HM Treasury that the Bank had warned of the risks in the economy through its regular Financial Stability Report in the build up to the subprime crisis erupting, however the Bank argued that its words alone had not been strong enough and therefore it required additional capabilities (Interview6, 2014) (Giles, 2012) (Milliken & Egenter, 2012). By suggesting HM Treasury had not acted upon its analysis in the past, the Bank was signalling that its credibility had been unfairly questioned when in fact it was the economic judgement of HM Treasury that should be the focus of credibility loss. As a result the Bank's senior officials argued strongly that delegation of a new gamut of capabilities was required along with macroprudential responsibility. It justified this policy-making capability on the basis that only a central bank possessed the technical expertise to discharge macroprudential responsibility appropriately. The Bank argued that macroprudential responsibility would entail an institution having to make potentially unpopular decisions in

order to prevent financial stress in the future, and therefore elected politicians would be conflicted due to their preference for electability. For example when the mortgage market is overheating bank capital requirements will have to be raised, effectively reducing mortgage lending in the real economy which in turn will prove unpopular with middle class voters (Interview6, 2014) (Interview15, 2015) (Interview16, 2015). HM Treasury accepted that new capabilities delegated to the Bank would be of little use without the discretion to act (Reece, 2012). Under the political explanation HM Treasury would not be expected to back down from its position, as the new government would be expected to want to control its macroprudential policy for the very reason of macroeconomic policy manipulation during election cycles. This was the same tactic used by governments that controlled monetary policy prior to central bank independence in the UK.

The Bank's highest priority when discussing new capacities was to protect its independence as a central bank. Thus it pushed very heavily for the creation of an FPC, without political interference, to fill the void in pre-crisis orthodoxy (Interview6, 2014) (Interview13, 2015). Bank officials had an 'off-the-shelf' committee structure in the form of the MPC, which was independent of the government. Thus the Bank put forward the case for the FPC to be modelled on the MPC structure simply because it had preserved the Bank's policy-making independence so successfully since 1997 (Interview19, 2015) (Interview13, 2015) (Interview6, 2014) (Interview20, 2015). Though there was one telling difference in the design of the FPC put forward by the Bank that ensured it was not at the same level of prestige as the MPC inside the Bank. The Bank designed the FPC as a sub-committee of the Bank's Court (Bank of England, 2014, p. 6). The MPC is not designed in this way. It has a very different governance structure that keeps its decision-making process away from the oversight of the Bank's Court (similar to a board directors) ensuring MPC decision-making cannot be questioned (Irwin, 2013, p. 123) (Treasury Select Committee, 2011, p. 126). The

idea behind this is that monetary policy-making remained the key objective of the Bank, a policy function that the governor regarded as most prestigious and wished to retain maximum influence over (Interview13, 2015). The Governor and senior officials were able to utilise its past experience of policy-making on monetary policy, and relative seniority of leaders to protect its autonomy. The Bank was the only institution that could lay claim to expertise in post-crisis regulation, now that the institutional constraints dictated the FSA would be abolished. It was effective in forcing the new and inexperienced chancellor to question the wisdom of not fully outsourcing macroprudential management of the economy to the central bank. The Bank faced no opposition from a rival agency or equivalent authority. HM Treasury had progressively rowed away from micro and macro economic policy-making over a number of since 1979. As a result the expertise that HM Treasury would require were no longer available to it on a permanent basis. HM Treasury cannot pay the salaries that satisfy individuals with the sufficient technical expertise at a working level. This lack of alternative bureaux to conduct macroprudential policy enables central banks to wield greater influence over the institutional reforms, moulding them in line with their own preferences. The source of this influence was its unrivalled expertise.

The evidence for this claim is provided in the following examples of interactions throughout the negotiation process. First, the Bank's leadership argued it would be a mistake to allow non-experts to comment on the Bank's policy decisions (Treasury Committee, 2011, p. 126). This line was reiterated to the Treasury Committee when the institutional reform's design was questioned in 2011 (Treasury Select Committee, 2011). The Bank self-defined non-experts as those not directly associated with the Bank (Treasury Committee, 2011, p. 126). Its strongest argument was that denying the Bank full autonomy over the FPC would risk leading markets to conclude the Bank's political independence had been compromised

(Interview5, 2014) (Interview6, 2014) (Interview13, 2015). Mervyn King's testimony to the Treasury Committee regarding the accountability of the FPC to political principals:

> *"I think you need an independent body to do that [discharge macroprudential tools] because the Bank is an independent Central Bank and it would be only too easy…for politicians to find a way round the independence of the Bank by interfering with the resources and budgets of the Bank"* (Treasury Committee, 2011, p. 126).

The Bank was able to resist the HM Treasury preference of political chairmanship of the FPC by also arguing to the Chancellor that creating a political chair of a macroprudential committee would simply re-create the Tripartite system that the new chancellor was so keen to make a symbolic break from (Treasury Select Committee, 2011, p. 132).

This argument of Bank expertise and distrust of political motives proved highly successful because it was difficult for HM Treasury to counter. When Bank officials reported resistance from HM Treasury during the negotiations, the Governor would apply pressure by writing directly to the Chancellor to express his frustration and reassert the Bank's preferences (Interview5, 2014) (Interview20, 2015). The new and relatively inexperienced Chancellor did not have the stomach for a public battle with a long serving governor and so HM Treasury eventually acquiesced to the Bank's demands (Interview20, 2015) (Interview5, 2014). It was openly acknowledged by the wider financial community that the new and inexperienced Chancellor lacked technical expertise and understanding of finance and regulation, which lends credibility to the source of influence for the Bank was its unrivalled claim to expertise in the UK institutional context (Treanor & Elliot, 2010) (Watt, 2012). (Jenkins & Murphy, 2010) (Jenkins & Murphy, 2010a). In this respect the timing of the general election was a critical institutional dynamic, enabling the central bank to exploit an important source of

temporal power, that being the Governor's experience and expertise, reputation and tenure, to leverage influence over HM Treasury.

In addition by this point in the process the US had already undertaken its equivalent macroprudential reforms in the US. The Bank was able to leverage off the criticisms of US macroprudential reforms by highly regarded regulatory experts, including former Fed deputy chair Don Kohn. The chief criticism of the US reform is that by placing a political principal in charge of macroprudential policy, the US has effectively ensured that the new toolkit will not be used at technically appropriate moments within the electoral cycle.

The Bank created the interim FPC on 17 February 2011, in advance of the statutory legislation being placed before parliament (Bank of England, 2018). The interim FPC was closely aligned to the Bank's preferences. The Governor rather than HM Treasury chaired it. In fact HM Treasury did not even have a vote on the interim FPC and it was created as a Bank committee of subordinate standing to the MPC. This interim FPC was formally made the permanent FPC when the Financial Services Act 2012 was voted through parliament on 19 December 2012 (HM Treasury, 2012). The government's initial proposal for a politically controlled FPC represented a gain for the HM Treasury but a clear loss to the Bank. If political explanations account satisfactorily for the macroprudential institutional reform the government would be expected to pursue its vision of political control over macroprudential regulation in order to retain the capability of manipulation of the credit cycle for electoral gains in the future. Instead, the government instructed HM Treasury not to pursue this preference despite the frustrations experienced with the Bank during the financial crisis. The new government was content to delegate economic management on arm's length terms.

The arrangements agreed under the interim FPC did not alter and the Financial Services Act 2012 received Royal Assent. The low number of veto players rendered the scope of the outcome wider. Hence the final design of the FPC emulated the MPC by enshrining a powerful mandate with minimal ex ante controls. Crucially, the Bank also ensured that monetary policy retained its pre-eminent position and would not be placed on an equal footing with macroprudential regulation. For example, the FPC has been designed as a committee of the Bank's Court, whereas the MPC is not; this ensures that monetary policy rests exclusively with the Governor (Bank of England, 2011, pp. 3-4) (Irwin, 2013, p. 123) (Interview13, 2015). The FPC also receives briefings from the MPC (Interview24, 2016). The governance structure also permitted crossover of membership between the two committees. This provided an informal mechanism for managing policy conflicts by giving the Bank the discretion to make macroprudential decisions subservient to monetary policy ones. The outcome therefore provides support for Proposition 2. The Bank was able to maximise its autonomy by securing an institutional design based on the MPC, while providing sufficient discretion for monetary policy to take precedence over macroprudential matters should a conflict arise.

6.5.2 Micro prudential Supervisory Reform

The topic then switched to *who should be in charge of micro level supervision*? Again the negotiation is between HM Treasury as principal and Bank as agent. At the beginning of the negotiation they had diametrically opposed preferences. As agreed during the political negotiation, the Coalition upheld the Conservatives' long standing commitment to abolish the FSA and transfer its supervisory functions to a new regulatory division within the Bank, with direct responsibility transferred to the Governor (Osborne, 2009). The Bank was critical of the changes, however, as it preferred to remain divorced from day-to-day micro-level supervision (Bank of England, 2009, pp. 433-34) (Interview6, 2014) (Interview13, 2015) (Interview15, 2015) (Interview16, 2015). From its perspective the political deal shifted the

scope for reform away from the status quo on supervision, which the Bank preferred, and towards the preferences HM Treasury. The prevailing institutional context forced the Bank to change its strategy and try to secure a final agreement closer to its own preferences – but still at a loss relative to the status quo.

The Conservative blueprint outlined the rational for centralising micro-supervision within the central bank and abolition of the FSA. This plan advocated that the prudential supervision of financial institutions would be located in a division of the Bank and that the FSA Chief Executive would simply become a Deputy Governor for financial regulation (Conservative Party, 2009) (Bank of England, 2018). However, Hector Sants, turned down the position because senior Bank officials insisted that any such appointment should only be made by the Governor (Conaghan, 2012, p. 255) (Treanor, 2013) (Interview13, 2015) (Interview5, 2014). Both the Bank and Treasury were equally unequivocal that regulation of financial conduct, the remaining element of the FSA's remit, would be located in a newly created consumer protection agency (Interview20, 2015) (Interview21, 2015) (Conservative Party, 2009).

The Government's detailed rationale for housing both macro and micro prudential supervision under the Bank's roof is contained within the Conservatives' White Paper (Conservative Party, 2009). First, the Conservative's viewed these powers as complementary and providing *'practical advantages'*. It was critical of the Bank's narrow mandate, arguing that control of interest rates should be closely coordinated with the supervision of individual bank balance sheets to strengthen regulators' capacity to respond flexibly to crises. Centralising all three functions would concentrate market and institutional insight into one authority and create a single point of accountability. In addition, delegating

conduct regulation and consumer protection to a separate agency would help to insulate banking supervision from '*political pressures'*.

The Bank, despite being publically supportive of the new Government's aims, was nervous about taking on micro prudential supervision (Interview13, 2015) (Interview14, 2015) (Interview20, 2015) (Interview22, 2015) (Keegan, 2010). The solution, according to the Bank, was to house supervisory capabilities in a separate agency and to limit involvement in the living banking sector to systemically important institutions. Recognising that it would still bear overall responsibility in the event of a crisis, however, it also insisted on retaining exclusive powers to direct the micro supervisory agencies. The Bank's strategy was therefore not to try to resist changes given the institutional constraints of the Coalition Agreement, but rather to remould them into something it could live with.

The Governor's strongly held position was that micro prudential issues should be kept as far away from the Bank's core monetary and macroprudential responsibilities as possible. However the institutional constraints imposed by the coalition agreement rendered the King's position untenable. This forced senior Bank officials to consider alternative options. Bank minutes highlight the views of Bank senior officials when considering the institutional reforms, as the minutes note *'it would be difficult to identify a set of institutions that the central bank could plausibly regulate on a day by day basis, while maintaining the focus of the senior team on monetary policy'* (Bank of England, 2008, p. 226).

The challenge for the Bank was to find ways in which the Bank could contribute to financial stability and have an impact on the micro supervisor, but over a narrower subset of the issues than the FSA was involved with (Bank of England, 2008, p. 226). This first, best alternative was that the supervision of firms should be conducted by a separate entity, but

one which the central bank would have the power to direct on the basis of its mandate for maintaining financial stability (Bank of England, 2008, p. 225) (Interview13, 2015) (Interview6, 2014). However, King recognised that the Coalition had a political mandate for reform and that the abolition of the FSA was a fait accompli (Conaghan 2012, p.254). Recognising the institutional constraints and that there was no alternative bureaux that could argue it had relevant expertise, rather than resist the changes, the Bank's leadership therefore set out to try to remould them into something it could live with. This bureau-shaping strategy caused the Coalition's original plans to partially unravel. The institutional design which emerged created two new bodies: the Prudential Regulation Authority (PRA), responsible for the prudential regulation and supervision of financial institutions; and the Financial Conduct Authority (FCA), which regulates financial products and consumer services. This differs from the institutional reform originally envisaged in three key respects: governance structures, division of responsibilities, and control mechanisms.

First, the Bank successfully resisted plans for micro prudential supervision to be fully integrated as a core directorate of the central bank. Rather it insisted that these functions should be housed in a separate subsidiary with its own legal personality and governance structure**.** This was essential to ensure that the new PRA would have full operational independence for day-to-day supervision and responsibility for firm specific decisions (HM Treasury 2010 p.29) (Interview13, 2015) (Interview14, 2015) (Interview20, 2015). The Bank argued that the FSA had been placed in a difficult position because it was intimately related to the financial sector and its authority was based on its acceptance within the financial sector. This in turn forced the agency to *'give and take'* (Bank of England, 2008, p. 227). If the financial sector did not agree with an FSA decision it would obstruct it, and had effectively done so in the build up to the crisis (Bank of England, 2008, p. 227) (Interview10, 2014) (Interview16, 2015) (Interview20, 2015) (Interview21, 2015) (Interview22, Interview

with FSA official, 2015) (Interview2, 2014). By distancing supervision from the Bank's core activities, the Governor was able to create a firewall between the two. This would safeguard the Bank's monetary policy autonomy. As a senior Bank official explained, '*having [the PRA] at arm's length is important; it doesn't need to be with us, but it does mean it must be arm's length'* (Interview6, 2014).

Second, the division of labour between the PRA and FCA has evolved such that firm-level supervision is effectively split between the PRA and FCA, contrary to the government's original intentions. The formal roles of the new regulatory agencies are ambiguous: while the PRA has prudential responsibility for '*all deposit takers, insurers and significant investment firms'*, the FCA provides prudential supervision for any institutions *'not regulated by the PRA'* (Bank of England, 2013, p. 1). King stated before the TSC the Bank's *'preference would have been not to have had responsibility for insurance companies'* but the institutional constraints of the coalition agreement meant the Bank was unable to resist this request from the government but in return it would lead to a different allocation of responsibilities between the Bank and FCA such that the FCA may take on more supervisory responsibly for with-profit life insurance (Treasury Select Committee, 2011, p. EV 54). In practice, however, the Bank has succeeded in limiting its direct involvement in supervision: hence the PRA is the lead supervisor for only those firms considered to be systemically risky, while delegating supervision of the majority of financial firms to the FCA (Delfas, 2015) (Interview21, 2015) (Interview22, 2015). The FCA prudentially regulates over 18,000 firms; whilst the PRA has ended up with just 1,500 (Financial Conduct Authority, 2016). Bank officials maintained that no regulatory regime could prevent a future crisis or bank failure. It was possible to limit the impact and improve regulation, but financial crises were endemic. A second argument was that it would be difficult to identify a set of institutions that the central bank could plausibly regulate on a day-by-day basis, whilst maintaining the focus of

senior officials on monetary policy (Bank of England, 2008, p. 226) (Interview13, 2015) (Interview14, 2015). The Bank was conscious of being blamed for bank failures in 1990s (Interview13, 2015) (Interview14, 2015) (Interview20, 2015) (Interview22, Interview with FSA official, 2015) (Interview5, 2014). Third, the Bank utilised the experience of the FSA, which it argued has been trying to do too much and as a result failed to build up significantly high quality expertise in important areas. By limiting the Bank's involvement with supervision it could better discharge responsibilities consistent with its role as the central bank (Bank of England, 2008, p. 227) (Interview14, 2015) (Interview20, 2015) (Interview22, Interview with FSA official, 2015) (Interview5, 2014).

Finally, the Bank also sought to enshrine the subordinate status of the two quasi-separate agencies by designing important control mechanisms. Hence both the PRA and FCA are required to comply with the Bank's broad recommendations on financial stability or publish a justification of why they disagree (Bank of England, 2013, pp. 10-11). The Bank's senior leadership also requested an increase in statutory powers, such as the ability to command the PRA and FCA to alter capital requirements of banks; and insisted that the PRA must wield *'backstop veto power'* over any FCA decisions that it deems a threat to financial stability (Treasury Committee, 2012, p. 29) (Interview22, 2015) (Russell, 2012). Court minutes published by the Bank show this was discussed internally by the Bank as an option that would require further exploration as early as 2009 (Bank of England, 2009, p. 398). The Court noted that:

> *"The absence of the right to receive information, other than through a request…was particularly concerning. It was suggested that the Bank would want to consider how it could address that gap in order to strengthen its position and perhaps seek a legislative change in the future"* (Bank of England, 2009, p. 398).

Crucially, these powerful levers were deemed necessary to ensure that the Bank could direct the new agencies on the basis of its new macroprudential objectives.

The process reveals that the Bank was able to resist the Treasury's original proposal and thus narrow the scope for reform. However, I argue that the final institutional reform still constituted a small loss for the Bank, relative to the status quo position on micro prudential supervision, which it preferred. From the perspective of the government, what emerged was far from ideal because the institutional design represented an inelegant compromise and less of a symbolic break with the past than the Chancellor had intended. In important respects it contradicted the government's own logic for scrapping the FSA. For example, locating micro prudential supervision in an operational subsidiary makes coordination with the Bank's core functions more difficult to achieve. In addition, the FCA's own prudential supervisory role contradicts the government's objective to separate this function from conduct regulation. The arrangements also left large parts of the financial sector, such as the insurance industry, unsure of its position on the fringes of the PRA (Interview13, 2015) (Adams, 2013) (Treasury Select Committee, 2011). Given that the government's primary objective was to strengthen coordination and accountability, the institutional design that emerged looks decidedly sub-optimal.

The Bank leveraged its influence over HM Treasury by again placing expertise and knowledge centre stage. Unlike the arena of macroprudential regulation, there was no epistemic community of regulatory experts arguing for a particularly model of micro-supervision over another. Indeed, different jurisdictions conduct micro supervision in many different ways. Fundamentally, it argued that henceforth firm-level supervision had to be recast in terms of financial stability (Bank of England, 2011, p. 5). This meant separating and subordinating micro prudential supervision to the Bank's new macroprudential mandate.

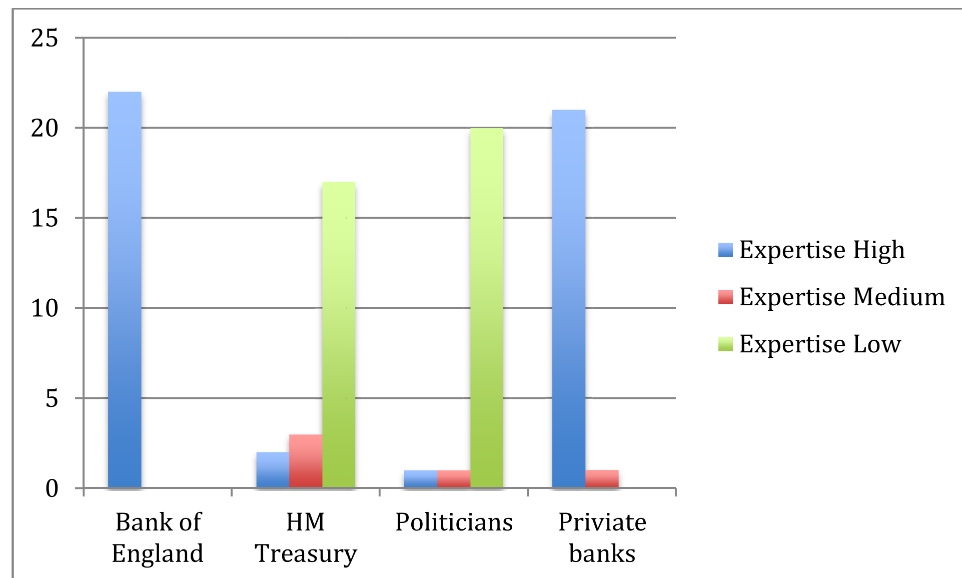
The final micro prudential reform passed by Parliament provided the Bank with supervisory capabilities over deposit-takers and insurers, via control of the PRA. The PRA was incorporated as a subsidiary of the Bank of England rather than a Prudential Regulation Directorate of the main Bank of England. This was materially different to the Conservative Opposition white paper and what the Coalition government envisaged. It allowed the Bank to row back the institutional reform to something that it could live with, whilst recognising the institutional context within which it had to negotiate micro supervisory capacity.

The central bank's motive was to maximise autonomy over core policy responsibilities, while hiving-off less desirable responsibilities to separate and subordinate agencies. This was achieved by establishing a complex series of lower-level PA relationships: between the Bank (as principal) and the PRA (as agent); and between the PRA (as principal) and the FCA (as agent). Significantly, the Bank also insisted on designing important ex ante and ex post control mechanisms to wield over these new agencies, powers that even government ministers have struggled to justify (Treasury Committee, 2012a, p. 29) (Bank of England, 2009, p. 398). The Bank was able to narrow the scope of reform significantly given it was negotiating in an environment of low bureaucratic concentration. There was no agency putting forward alternative options to the government, beyond HM Treasury.

6.6 Sources of central bank influence

The question remains, *what was the source of the Bank's influence that allowed it to move the institutional outcome closer to its own preferences?* Throughout the chapter references to the expertise of the Bank have been made in a wide-range of sources.

Figure 13: UK Interviewee responses to perception of technical expertise on the issue of macro and micro supervision held by the institutional reform actors. (Source: interviews conducted by the author).



This research has revealed all actors in the process perceived the Bank to possess high levels of technical expertise in the fields of macro and microeconomics, relative to other actors. This was crucial when negotiating the outcome with HM Treasury. Had the FSA been an active participant in negotiations post-general election it too could have been considered as possessing strong technical expertise, particularly in the realm of micro-supervision. It had highly respected and credible leaders in Hector Sants and Adair Turner. HM Treasury is considered as lacking technical expertise at working level. Both HM Treasury and the BoE were aware of this and it hung over the negotiations.

Senior Bank officials have direct access to senior government officials and HM Treasury ministers. The Bank used this line of communication to emphasis its credibility and expertise at the highest level during the negations with HM Treasury. For example, the Governor

wrote directly to the Chancellor to settle working level disagreements on occasions when HM Treasury defied the Bank's preferences. A senior HM Treasury official stated:

> *'The Bank officials did escalate quite a lot up to the level of the Governor, and when the Governor writes a letter it's quite difficult to argue against it….the Bank tended to be much more forceful'* (Interview5, 2014).

More broadly, the relationship between the Bank and government is one of expert advisors to elected officials, and increasingly, to the HM Treasury. This relationship has evolved as the Treasury's purpose has inclemently changed. Pre-1992 HM Treasury was responsible for banking regulatory policy, though supervision was done elsewhere. Since the creation of the FSA in 1997, it had lost that depth of technical knowledge (Interview5, 2014) (Interview4, 2014) (HM Treasury, 2009).[19] This re-balancing of the relationship provided the Bank with credibility and expertise that it was able to exploit to influence the institutional reform.

The central bank also operates on the assumption of institutional permanence which allows it be more forceful in pursuit of its preferences. The Bank is safe in the knowledge that it will not abolished for defying its principal in the same way that an agency regulator such as the FSA would be. For example, the Bank's *'big bazooka'*, discussed in both the macro and micro prudential negotiations, was to signal to markets that it is no longer autonomous (Interview5, 2014) (Interview6, 2014). Accounts of the process highlight that HM Treasury officials were acutely aware of this, despite the threat remaining implicit rather than explicit on the part of the Bank. The use of this subversive power began early on, under the previous Labour government, when the Bank was willing to publically disagree with the Chancellor's macroprudential reform plan. Using its Governor's credibility and perception of

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[19] HM Treasury has lost all the institutional memory with technical banking regulatory expertise since the 1960s. HM Treasury has been streamlined since it was split in half in 1964, with the creation of the Department for Economic Affairs. This splinter department did not last long and was defunct by 1969. It was broken up and its responsibilities dispersed amongst other Whitehall departments.

expertise it signalled to the Opposition the Bank's preference on macroprudential reform, allowing the Bank the opportunity to enhance its capabilities once a change in government occurred. It met with the prospective Conservative government to discuss their plans for institutional reform, providing another opportunity to influence principal preferences and providing time to strategise ahead of the May 2010 general election.

6.7 Assessment of propositions

This chapter has documented the increase in capabilities of the Bank of England post financial crisis. It has done so by applying an ACI framework in which outcomes are the result of the interaction among actors, constrained by the institutional setting in the realisation of their preferences.

In summary, the outbreak of the financial crisis took all UK actors by surprise. It was the critical event that forced political elites to reconsider their preferences regarding supervisory architecture. Without this re-configuration of political preferences the casual chain that resulted in institutional reform would not have occurred. The status quo would have remained and it is likely that the Labour government would not have lost the May 2010 general election. The high-profile nature of the crisis made it the background narrative to the 2010 General Election. The major political parties were forced to confront the crisis with new ideas. There is a natural benefit to being in opposition in times of crisis, that is to say opposition party's are not held to account for decision-making. The Conservative Party was able to change course from shadowing Labour's economic policy and generate a new narrative of blame for the crisis for electioneering purposes. This was aided by the high profile criticism of the FSA from Treasury Committee enquiries into the run on Northern Rock on 14 September 2007 and ultimate nationalisation in February 2008, and the subsequent re-capitalisation of the UK banking sector in October 2008.

Based upon the predictions made in Chapter 2, if the main propositions hold true, the process should reveal bureaucratic actors subvert the institutional reform. The UK case study exhibits a high concentration of bureaucratic power, with low political veto possibilities. I have argued that the central bank should be able to effectively subvert the intended institutional reform, resulting in an outcome closer to its own preferences.

Figure 14: Outcomes of UK case study

		Bureaucratic Structures	
		Concentrated bureaucratic power	**Diffuse bureaucratic power**
Institutional Constraints	**High political veto possibilities**	*Absorption*	*Layering*
	Low political veto possibilities	*Subversion* **(UK)**	*Displacement*

The remainder of this section discusses the competing propositions one by one.

6.7.1 Institutional constraints (P_1)

A lack of checks and balances in the UK made it easier for the new coalition government to push through institutional reform. This reform was facilitated by political institutions characterised by few checks and balances that concentrated power in the hands of the executive and offered few obstacles to altering the institutional organisation of financial reform. Once the Coalition partners had reached an agreement to form a government, the process of gaining parliamentary approval was guaranteed. This was due to a "strong" party system that characterises the Westminster model of democracy. This means political parties have clear and coherent positions on policy issues, with all members usually united behind those positions, and they vote as a block. Individual politicians careers are bound to those of the leadership and thus the prospect of mass defection is low. Both political parties in

coalition had been locked out of government for many decades and thus did not wish to risk looking divided on a key element of their joint platform and hence individuals did not defect from the executive position. Within this institutional constraint the Liberal Democrats and Conservatives together held 363 seats out of 650 in the House of Commons. The upper chamber, as a principle, does not veto legislation when it is deemed to have popular support (ie. It has been the centrepiece of an election campaign). This principle was applied to the Coalition approach to regulatory institutional reform. Thus the upper chamber veto was not a relevant factor.

The Conservative party alone had the largest number of seats in the House of Commons, despite not reaching the 326 seats required for an overall majority. Without the Coalition Agreement the Conservative government could have attempted to govern as minority government, but the opposing 344 votes in the House of Commons could have vetoed its institutional reform programme. The Liberal Democrat and Labour opposition votes would have totalled 315. It is reasonable to assume that in the absence of the Coalition Agreement, the Liberal Democrats would have joined Labour in opposing the Conservative institutional reform agenda because, like Labour, the Liberal Democrats manifesto supported retaining the tripartite system of regulation but enhancing the FSA's powers (Liberal Democrats, 2010, p. 17). Thus the coalition agreement, and the institutional constraints it imposed on actors, was a necessary condition in achieving the institutional reform outcome. As a result the proposition is supported by the research.

6.7.2 Bureaucratic Politics (P_2)

The tripartite system of financial regulation in place at the outset of the financial crisis had three bureaucratic players. If the system had been maintained then bureaucratic competition would have continued irrespective of which political party was in power.

First, the bureaucratic competition between the Bank and FSA began in October 2008 when Labour Chancellor, Alistair Darling, asked Adair Turner to conduct a review of the crisis. At this stage the Bank was acutely aware of the Chancellors frustration with its moral hazard arguments in relation to the resolution of Northern Rock and the re-capitalisation of the banking sector post-Lehman Brothers collapse. The Review made a number of recommendations to improve macroprudential regulation, as Turner had been an early convert to the new ideas being promoted by an epistemic community. It was at this point that the Bank altered its preference on involvement in macroprudential supervision, in response to a potential loss of authority to the FSA. In this environment of dispersed bureaucratic power the Bank found it more difficult to convince political principals of the need to empower the Bank with macroprudential capabilities. The turning point was once the Bank realised that another institution, other than the Chancellor, would have a significant role in the Bank deploying its LOLR capabilities. The Governor and the Bank's Court were concerned that the Bank would have to undertake operations base based upon the analysis of non-Bank personnel at the FSA. It would, in effect, be the subordinate partner in the re-invented tripartite system. This was an unacceptable compromise for Mervyn King. The result was King openly criticising the Chancellor's institutional reform in his highest profile domestic speech of the year on 17 June 2009 (King M. , Speech given by Mervyn King, Governor of the Bank of England At the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House 17 June 2009, 2009). The Bank's governor stated: *'…it is not entirely clear how the Bank will be able to discharge its new statutory responsibility if we can do no more than issue sermons or organise burials'* (King M. , Speech given by Mervyn King, Governor of the Bank of England At the Lord Mayor's Banquet for Bankers and Merchants of the City of London at the Mansion House 17 June 2009, 2009). Within this environment the Bank was ineffective in altering the preference of

the Labour government, despite pointing to examples of macroprudential central bank-led capabilities abroad. The Labour plan was to add layer a new macroprudential council on top of the existing architecture. This is consistent with the prediction.

Second, post-general election, with the institutional constraints imposed by the new Coalition Agreement signed in May 2010, the Bank was operating in an environment of low bureaucratic contestation. The clear message since mid-2009 from the Conservative campaign was that the FSA would be abolished (BBC, 2009). The Conservative plan was to transfer the micro supervisory capabilities of the FSA to the Bank. Though not aligned to the Bank's preferences, the Conservative plan effectively removed the FSA's bargaining power from the equation concentrating meaningful bureaucratic influence in the Bank of England. Whilst the FSA continued to exist until January 2013, accounts of the negotiations that took place post-general election reveal an acceptance from the FSA that it would no longer exist and that the Bank became the only forceful bureaucratic institution seeking to influence the direction of reform (Interview13, 2015) (Interview20, 2015) (Interview5, 2014). The FSA did not seek to resist the plans due to the institutional constraints. This left the Bank to negotiate institutional reform directly with HM Treasury.

6.7.3 Political explanations

The reasons for the Conservative and Liberal Democrat government pursuing institutional reform is compatible, in part, with the political explanation proposition. The reasons provided by the Chancellor George Osborne are clear, the crisis was to be used as a tool with which to discredit the incumbent Labour government.

First, the Shadow Chancellor poached one of the key civil servants in the Labour run HM Treasury, James Sassoon. Gordon Brown had initially appointed James Sassoon to the

position of Special Envoy to the City at HM Treasury whilst Chancellor. Sassoon continued to serve under Brown's successor, Alistair Darling. The Shadow Chancellor, George Osborne MP, poached Sassoon in late September 2008, shortly after the collapse of Lehman Brothers (Interview5, 2014) (Interview13, 2015) (Interview3, 2014) (Eaglesham, 2009a) (Hall, 2009, p. 37). Sassoon was given the position of chairman of the Conservative Party's economic recovery committee and tasked with undertaking a review of banking regulation in the UK (Rawnsley, 2010, p. 477) (Sassoon, 2009) (Hall, 2009, p. 37). Sassoon was appointed to pick apart the tripartite system to which the Conservative's could attribute responsibility for to Brown and Labour (Rawnsley, 2010, p. 477) (Interview1, 2014) (Interview2, 2014) (Interview20, 2015) (Interview3, 2014). The defection by Sassoon was widely reported as an indictment of Labour's regulatory and economic policymaking competence.

The Sassoon report presented a number of options. However, on closer inspection these options all involved diminishing or abolishing the FSA and putting the Bank of England at the heart of micro and macroprudential regulation. Sassoon's options are summarised below (Pennington, 2009).

Second, following the 2009 European election the Conservative opposition met with Bank officials to present its version of institutional reform. The Sassoon recommendations formed the basis of this meeting. At this point the Bank was unhappy with the reforms thus far under the Labour government (Conaghan, 2012). Chancellor Darling had revealed the preference for the FSA to become lead macroprudential regulator over the Bank, and create a new layer of regulatory consolidation involving all members of the tripartite.

In July 2009 the Conservative Party published a policy White Paper, based upon the Sassoon report, which confirmed the Conservative's desire to abolish the FSA and transfer its

capabilities across to the Bank (Osborne, 2009, p. 2). The White Paper clearly indicates that the Conservatives saw no role for a consumer protection agency to be involved in micro prudential supervision of firms (Conservative Party, 2009, pp. 14-16). Yet the final institutional reform made the FCA the largest prudential regulator in Europe. Thus the Conservative preference for institutional reform was not applied in a hierarchical manner from above once the Conservative Party took control of the Treasury on 6 May 2010.

This White Paper, and the majority of the Sassoon report, was far from completely aligned with the Bank's preferences (Hall, 2009, pp. 2-3). It was clear to the Bank's hierarchy that the Conservative team wished to use institutional reform in order to make a clear political point in terms of blame for the crisis (Wintour & Leigh, 2010). Mervyn King affirmed this by stating:

> *"Cameron and Osborne have a tendency to think about issues only in terms of politics and how they might affect Tory electorability"* (Wintour & Leigh, 2010).

The Bank also expressed concerns that the new Conservative hierarchy was resistant to reaching out beyond their small inner circle for policy advice (Wintour & Leigh, 2010) (Interview6, 2014).

Third, the Conservative party did not win enough seats at the 2010 election to form a government. As a result they had to form a coalition with the Liberal Democrats. Whilst both parties agreed that institutional reform was a priority, they had diametrically opposed preferences. The Coalition Agreement ensured a way forward that preserved the Conservative preference for regulatory reform in a way that also preserved the stability of the government. It ensured that both the Conservative and Liberal Democrat backbenches would vote for the final institutional reform.

There is a major problem with the political explanations proposition, as explained by the literature. It assumes that politicians conceive of institutional reform as tool for electoral victory and then implement the reform hierarchically in order to reap the electoral rewards in the future. Yet the Conservative preference was not successfully imposed upon the Bank, and it backed down when confronted with central bank resistance. For example, HM Treasury was unsuccessful in gaining political control of the FPC. Second, all prudential regulation should have been moved across to the central bank and a new prudential regulation division would have been created with Hector Sants, FSA CEO, as Deputy Governor of Prudential Regulation (Bank of England, 2018). The FCA should have been limited to conduct regulation, yet has ended the institutional reform process as the largest prudential regulator in Europe. The institutional outcome is far more blurred, with the FCA retaining large chunks of prudential regulatory responsibility. The PRA was created as a subsidiary of the central bank. This in effect ensured that prudential regulation did not rank as highly as monetary policy objectives within the central bank. When the autonomy of the Bank was threatened the Bank Governor would open up a direct channel of communication with the Chancellor, who backed-down. The new and inexperienced Chancellor was not willing to risk having his reputation publically questioned by entering into a public dispute with an experienced central bank official.

In addition, this explanation ignores the historical preferences of the Conservative party in relation to the financial sector. The Conservative party likely had an existing preference to abolish the FSA, as it dismantled the party's closeness to the industry and created a new regulatory locus through which the Labour party was able to built its own links with powerful international banks. Thus the Conservative preference is not be fully explained by the political strategy post-crisis in isolation.

6.7.4 Financial Industry lobbying

The financial sector had little influence over the outcome of institutional reform in the UK. There was no significant lobbying campaign to ensure a particular institutional arrangement in the UK (Interview10, 2014) (Interview12, 2014) (Interview14, 2015) (Interview20, 2015). This is unexpected on the basis of the strength of the financial sector lobby in the UK (Langdon, 1961, p. 527). In the decades preceding the financial crisis the UK financial sector enjoyed a close relationship with governments on both the left and right. For example, Tony Blair, when prime minister, directly intervened in the FSA regulatory approach, imploring it to take a proportionate approach for the financial industry (Interview20, 2015) (Interview2, 2014). This was in direct response to industry concerns. On this occasion, industry responded to government consultation documents in writing, via the BBA, but did not seek direct meetings with HM Treasury to lobby for a particular outcome.

This institutional reform was different for the following reasons. First, in the aftermath of the financial crisis and bank bailouts, public opinion firmly opposed concessions for the banking industry. This made politicians significantly less responsive to industry concerns about altering the regulatory architecture. The financial sector had realised this early on in the reform process. A concern of the BBA was the potential inefficiently of the Conservative's twin peaks model, fearing firms would be forced to duplicate regulatory returns. The government opted to forge ahead and implement the twin peaks model despite this. The government relied heavily on the expertise provided by the Bank, rather than the financial sector monopolising the information supply. For example, the Conservative party met with the Bank whilst in opposition (Conaghan, 2012). Throughout HM Treasury and Bank negotiations on both macroprudential and micro prudential reform, the Bank was still able to control supply of information, via its governor, directly to the chancellor.

Second, the Conservatives blamed Labour for the financial crisis during the 2010 general election campaign linking the crisis to the 1997 intuitional arrangements. By extension, this amounted to criticism of the FSA for not spotting the signs of the financial crisis. The Conservative key message was that transferring its supervisory powers to the Bank would lead to more efficient rule-making: it would strengthen regulation because it would be less prone to industry capture (Conservative Party, 2009). But the Conservative party's preferences were also path dependent to the extent that they were shaped by past institutional choices. As previously mentioned, historically the Conservatives had strong links with the City of London and the BoE was an important part of its political network (Moran 1991) (Interview16, 2015) (Interview13, 2015) (Interview5, 2014). The Conservatives opposed the FSA creation in 1997 because it potentially allowed the new government to expand its own sphere of influence in the City by establishing a new source of institutional support and patronage. Any deviation from abolition of the FSA, or alterations in favour of industry following the crisis, would have damaged the credibility of a party that had been locked-out of government since 1997.

Third, the Coalition Agreement, reached on 13 May 2010, between the Conservative party and Liberal Democrat party committed the government's survival on enacting a specific type of institutional reform. First, reform of the tripartite supervisory system by abolishing the FSA and transferring most of its responsibilities to the Bank of England; and second, a commitment to establishing an independent commission to investigate the viability of structural reform in the banking industry (Gamble, 2012, p. 65). This institutional constraint effectively locked out financial industry influence. The benefits of liaising with financial industry lobbyists were heavily outweighed by the need to retain political power. A single

party government may have found itself more open to the power of the financial lobby in the UK.

Fourth, firms were also acutely aware that institutional reform could provide them with a competitive advantage in the UK if markets believed the new institutional arrangements made the UK aided the safety and soundness of the UK banking sector. The financial industry recognised it was in a weakened state at this time and chose not to expend its political capital on opposing regulatory change. Instead industry was concerned with future policy battles, such as structural reform and leverage restraints.

In summary the UK government was not hostage to the demands of a well-resourced financial sector, exerting pressure for a particular outcome. The financial sector did not have any strong preferences for the institutional reform that it advocated externally. The financial sector was, therefore, not a key source of information for parliamentarians on this issue. As a result the financial industry-lobbying proposition is significantly weakened.

6.7.5 Diffusion of Ideas and Epistemic community

How influential were the ideas of the epistemic community of regulatory experts for explaining this outcome? Prior to the period being studied macroprudential ideas had been discussed amongst the BIS members but only in small enclaves (Baker, 2013). The financial crisis gave macroprudential policy an extraordinary boost (Borio, 2009, p.32). As Borio has pointed out, '*a decade ago the term macroprudential was barely used and there was little appetite amongst policy makers and regulators to even engage with the concept, let alone strengthen macroprudential regulation'* (Borio, 2009, p.32) (Baker, 2013). How did this happen?

In the decade preceding the crisis the UK government had no incentive to adopt macroprudential ideas as continued financial innovation accounted for 25% of tax returns (Baker, 2013). It was not a salient issue in economically buoyant times. Politicians and the FSA had accepted that markets were entirely rational, it had *'become part of the institutional DNA'* (Turner, 2011). In addition, Bank of England Governor, Mervyn King, did not view macroprudential policy as a capability of a modern central bank (Interview22, interview with FSA official, 2015) (Interview22, Interview with FSA official, 2015) (Interview13, 2015). Whilst the collapse of Northern Rock was not enough to break the belief in efficient and rational markets, the collapse of Lehmann Brothers, and the subsequent impact on UK banks in late 2008 eventually was. It was at this point the epistemic community that had been quietly advocating the importance of macroprudential capabilities gained a vehicle for its ideas, in politicians that were now willing to listen and champion a solution to the worst financial crisis in living memory (Baker, 2013). The idea of macroprudential policy was appealing to politicians because it '*promised to limit future potential market losses, to reduce future calls on public finances'* (Baker, 2013). The extent of the crisis resulted in space for policy entrepreneurs to promote their idea directly to politicians.

In the UK, it was the FSA that took up this task, via the Turner Report (2009). Turner himself had been influenced by discussions at the BIS (Baker, 2013). The Labour Government commissioned the Turner Review. Turner was the newly appointed chair of the FSA and was not tainted by the crisis. The report recommended that the Bank of England and the FSA should be '*extensively and collaboratively involved in macroprudential analysis and the identification of policy steps. Measures such as counter-cyclical capital and liquidity requirements should be used to offset these risks'* (Turner, 2009). Turner also took the opportunity to promote an '*enhanced supervisory approach'* for the FSA (Turner, 2009). In doing so Turner was attempting to cement the relevance of the FSA (Interview5, 2014)

(Interview4, 2014) (Interview3, 2014) (Interview2, 2014). It is clear that both the Labour and Conservative party's had bought into the idea of macroprudential regulation. However, they proposed to adopt them in very different ways. Labour wished to empower the FSA with macroprudential capabilities, whist the Conservative party wished to empower the Bank.

The power of ideas explains why the concept of macroprudential regulation formed part of the reform process. Crucially, the epistemic community was not directly responsible in influencing the precise institutional architecture through which macroprudential policy was eventually discharged in the UK. Proponents of macroprudential supervision in the UK epistemic community did not reach a consensus on a lead agency to discharge macroprudential policy. For example different political parties chose different locations for macroprudential capabilities to reside. The power of ideas is not able to explain why the Bank was initially hesitant to take up the macroprudential mantle. The Bank's preference on macroprudential capability altered as a result of the bureaucratic politics resulting from the political actors preferences for institutional reform. If the influence of an epistemic community was able to account for the precise architecture of the reforms there should have been a clear steer from the epistemic community on the location of such supervision. However, what we have seen globally is macroprudential supervisory capabilities dispersed across different regulatory actors in different polities – not just delegated to central banks. The evidence shows that this emerging international debate on regulation concerned the Bank as it envisaged a different or greater role for central banks. The Bank discussed significant changes to the structure of US regulation proposed by the Obama Administration that would move the US system closer to a separation of business and consumer protection on the one hand, and capital and liquidity regulation on the other (Bank of England, 2008, p. 215). As a result the epistemic community proposition is significantly weakened as an explanation for the outcome of the institutional reform.

Ultimately the way in which expertise influenced the outcome of the institutional reform was not through a shared belief amongst an epistemic community of experts, but rather as a power resource that allowed the central bank to steer political principals towards an outcome that was closer to the Bank's preferences.

Chapter 7: Domestic and International Sources of Institutional Reform

7.1 Introduction

The previous chapters have documented how far-reaching reforms strengthened the role of national central banks in the US and UK to maintain financial stability. The nature of these reforms to central banks' capabilities has been refracted by domestic political dynamics rather than international dynamics. This has produced important divergence in the institutional design of post-crisis reforms, specifically related to the location and oversight of new macro and micro prudential capabilities.

This chapter proceeds as follows. The second section summarises the process of institutional reform in the US and UK. The third section undertakes a comparative analysis of the macro and micro prudential reforms in the context of the propositions tested throughout this thesis. The final section summaries the conclusions of this thesis and the theoretical contribution it makes to the literature on post-crisis institutional reform.

7.2 Summary of Case Studies

In the US and UK cases, the outcome of reform diverges significantly from that originally planned by the executive and produced two distinct modes of institutional change. In the US high veto possibilities (arising from political institutional constraints) combined with diffuse bureaucratic power (due to the fragmentation of regulatory bureaux) presented an insurmountable obstacle to the Obama Administration's plan to strengthen the prudential powers of the Federal Reserve. In response, to an alliance of political, bureaucratic and industry interests, the Administration was forced to pursue institutional layering. This meant leaving the existing institutional architecture largely in place, while circumventing opposition by creating a new institution for managing macroprudential policy-making (the

Financial Stability Oversight Council). This macroprudential negotiation set in place a process that led to Congress inadvertently enhancing the Fed's discretionary macro- and micro prudential powers *'via the back door'*. In the UK, by contrast, low veto possibilities (owing to the government's parliamentary majority) facilitated the Coalition Government's proposals for institutional displacement by scrapping the Financial Services Authority (FSA) and centralising prudential policy-making within the Bank of England. Yet this concentration of bureaucratic power also provided scope for the strengthened central bank to reshape the reforms in line with its own interests: a form of institutional change this research labels as subversion.

7.2.1 A Financial crisis, general elections & shaping actor preferences and strategies

In the US, the byzantine regulatory architecture for banking has evolved incrementally over many decades. As the sector expanded and diversified, new regulatory agencies were added, creating a highly fragmented system (Carpenter 2010; Jacobs and King 2016)[20]. Prior to the 2007/08 crisis the Fed was responsible for overseeing around 5,000 bank holding companies and 850 state-chartered banks that were part of the Federal Reserve System. However, responsibility for regulating and supervising individual banks was shared amongst several regulatory bureaux.

The turmoil in the US banking system in 2008 challenged the prevailing consensus in favour of financial deregulation, and provided the backdrop to the US presidential election. Republican candidate John McCain vowed to crack down on Wall Street 'greed', but offered no detailed proposals on how banking supervision should be reformed (Holcomb 2013). By contrast, Democratic Presidential candidate Barack Obama attacked the incumbent Republican Administration's failures for contributing to the crisis. Obama advocated

[20] For full explanation of institutional regulatory reform see chapter x.

strengthening the Federal Reserve by giving it new macroprudential powers and enhanced supervisory authority over most financial institutions, and expressed a desire for regulatory consolidation centred on the Fed (Obama 2008). The outcome of the election saw Obama elected to the White House, while the Democrats increased their control of the House of Representatives and took control of the Senate. This provided a strong mandate for institutional reform.

Financial regulation in the UK was originally built on a club-based system with little, if any, statutory regulation (Moran 2009). Following the 1986 Financial Services Act, the Bank of England gained new statutory powers over bank supervision and surveillance. In 1997, the new Labour government granted the Bank of England operational independence for setting interest rates but stripped it of supervisory authority, handing this responsibility to a new single supervisory authority, the FSA. The decision was a response to the supervisory failures of the Bank during the preceding decade, and a desire to make bank supervision more accountable to government (Westrup 2007). This created a new 'tripartite' system in which responsibility for financial regulation was shared between the Bank of England, the FSA, and HM Treasury (McPhilemy 2013).

The collapse of major UK banking institutions in 2008 sent shockwaves through the political establishment, and forced a fundamental re-evaluation of the UK's regulatory regime in an effort to restore financial stability. During 2009, the UK Parliament launched a series of inquiries that directed criticism at the tripartite system and the FSA's 'light touch' supervisory culture (Treasury Committee 2009). In the run-up to the general election in May 2010, the incumbent Labour Party pledged to defend the existing tripartite system by granting new macroprudential powers to the FSA. By contrast, the opposition Conservative Party promised to abolish the FSA and transfer most of its regulatory and supervisory

responsibilities to the Bank of England (Conservative Party 2009, pp. 14-16). Following the general election, the Coalition Agreement between the Conservative and Liberal Democrat parties committed the new government to implementing the Conservatives' manifesto plan for wholesale reform.

Despite the striking similarities in the reform proposals put forward by both governments, the outcome of institutional change – enshrined in the Dodd-Frank Act (2010) in the US and the UK Financial Services Act (2012) – reveals substantial variation between the two countries, and divergences from what was originally proposed by each executive. In important respects, the UK reforms went further than the government's initial plans, handing the Bank of England complete control of macroprudential policy-making, but allowing it to delegate micro prudential supervision to subordinate agencies. By contrast, the Obama Administration's plans for centralising prudential powers and consolidating supervision in the Federal Reserve were thwarted, forcing it to leave the existing architecture largely in place and to create a new institution, layered over the existing structure, to provide macroprudential oversight.

Both the US and UK held general elections in the middle of the financial crisis. The US election took place in November 2008, whilst the UK general election was held in May 2010. In the US the incumbent Administration was Republican but in its final term. This meant the incumbent President, George W. Bush, was unable to run again. John McCain became the centre-right Republican candidate for the presidency, whereas the Democrats opted for centre-left Senator Barak Obama. In the UK, the incumbent Labour government was seeking a fourth term; with the main opposition provided by the centre-right Conservative party.
Given the intensity and prolonged nature of the financial crisis the topic unsurprisingly became the background narrative for the election campaign in both the US and UK, forcing

political parties and candidates to generate ideas and new preferences on regulatory arrangements. Banking regulation, throughout the crisis, moved from one of low salience to high salience in both polities.

In the US, candidate Obama tied the incumbent Republican Administration's policy decisions to the worsening economic situation (Obama, 2008a) (Daily News Staff, 2008). Obama stated his belief that the Federal Reserve Board should have *"basic supervisory authority"* over those that access its lender of last resort (LOLR) function (Obama, 2008a) (Bernanke, 2015, p. 437). In doing so Obama revealed a preference for streamlining the existing *"framework of overlapping and competing regulatory agencies"* and empowering the central bank (Obama, 2008a). In addition the Obama campaign questioned the financial regulation voting record of candidate McCain in an attempt to link his voting record to the de-regulatory agenda of the incumbent President. The weak party system of the US presidential system makes it more difficult to tie individuals in the same party to the decision of the executive. Nonetheless, the McCain campaign was irreparably damaged by the combination of the Obama campaign strategy and its own inability to articulate solutions.

In the UK the political competition process followed a similar pattern, though the Conservative party were able to directly blame an incumbent government in the general election campaign. The Westminster system meant that members of the incumbent government are directly tied to the decisions of the Labour government. In particular the Chancellor the for previous decade was now Prime Minister. At the time of the Northern Rock nationalisation George Osborne, Shadow Chancellor, used the event to discredit the economic competence of the incumbent Labour government. The Conservative strategy

became one of criticism of Labour action without having to put forward its own crisis management strategy. The Conservative 2010 election manifesto stated:

> *"We will abolish Gordon Brown's failed tripartite system of regulation and put the Bank of England in charge of prudential supervision. We will restore the Bank's historic role in monitoring the overall growth of credit and debt in the economy"* (Conservative Party, 2010, p. 29).

Both in the UK and US, opposition politicians advocated alternative institutional reforms, centred on increasing the capabilities of central banks, for electoral gain. The result of both elections saw incumbent parties lose control of the executive and legislatures. The effect of this in the UK and US on the ability to enact institutional reform diverges significantly – given the political institutional constraints, which makes it far more difficult to whip politicians in the legislature. In contrast, the Westminster system, characterised by a strong party system, makes the likelihood of institutional reform being imposed by the executive significantly greater.

7.2.2 Central bank reform in the US and UK

Upon taking office, President Obama wasted little time in developing plans to strengthen the Federal Reserve. The new Administration worked closely with the Fed to begin drafting legislation that proposed sweeping changes to its macro- and micro prudential role (Interview30, 2016) (Interview31, 2016) (Interview30, 2016) (Interview39, 2016). The nature of the US system means that although the Administration may set the legislative agenda, it is difficult to command and control the legislature. Thus institutional reform would be negotiated with all actors after the Administration and Federal Reserve had drawn up their preferences for reform. As predicted by the framework this resulted in politicians facing a number of obstacles and thereby reduced the scope for institutional reform.

Following the 2010 general election in the UK, the new Coalition Government enjoyed a workable majority in Parliament. Its ability to command strong executive leadership, underpinned by the relative absence of institutional or partisan veto possibilities in the Westminster system, greatly facilitated the government's plan to embark on institutional reform through displacement. Recognising that there was little political capital to be made from defending the FSA, and convulsed by its own internal leadership context, the Labour opposition offered little resistance to its abolition (Conaghan 2012). Yet the government's reform strategy faced two main challenges. First, although the Coalition Agreement had decisively settled the question of where new prudential powers would be located in favour of the Bank of England, the institutional framework for managing these new powers was still to be determined. Second, by scrapping the tripartite system and handing prudential responsibility to the central bank, the government had concentrated bureaucratic power in the hands of a single agency. As predicted by the framework, this provided considerable scope for powerful bureaucratic actors to reshape institutional reform.

7.2.3 Macroprudential Reform in the US and UK

In the US, the Treasury and Fed agreed that the Fed should be granted extensive new macroprudential powers that should reside in the Fed's existing President's Working Group (Interview30, 2016) (Interview31, 2016) (Interview33, 2016) (Interview35, 2016) (Interview34, 2016). Creating a small macroprudential council within the central bank was deemed essential to strengthen regulators' capacity to respond to crises, and to protect the Fed's LOLR function from interference by other regulatory agencies. As in the UK, the government insisted on retaining control by proposing that the Treasury Secretary, rather than the Fed Chairman chair the new council. These proposals formed part of a wider package of financial regulatory reforms for which President Obama set out to secure cross-Congressional support. This meant securing a filibuster-proof majority in the Senate (60

votes, of which the Democrats were short by 3) in order to send a credible signal to the financial markets about the durability of the changes. As a result, senior Congressional leaders in both parties were effectively empowered with important veto powers over the reform process.

Problematically, opinion within Congress became increasingly hostile towards the Fed and it was singled out by a bipartisan inquiry for its failings during the financial crisis (Financial Crisis Inquiry Commission 2011). Criticism of the Fed came from both sides of the partisan divide: Republicans attacked its use of emergency powers to rescue failing financial institutions, while Democrats believed it had failed to protect borrowers from abusive lending practices (Goodhart 2015, p. 284). As a result, the Obama Administration's plan for reforming the Fed met with stiff opposition from key Congressional leaders; largely Chris Dodd, Chairman of the Senate Banking Committee. As a counter proposal, Senator Dodd published a Bill recommending the creation of a new Agency for Financial Stability, headed by an independent chairman appointed by the President, in which all macroprudential powers would be located (Interview32, 2016) (Interview31, 2016) (Interview30, 2016) (Crowley, Heiman, Shah Page, Holman, & Clark, 2009) (Masters et al., 2009). These efforts to constrain the power of the Fed were strongly supported by other regulatory agencies. Bureaucratic resistance to the Administration's plans were led by Sheila Bair, Chair of the FDIC, who insisted that the authority of other regulators should not be subordinate to a Fed-dominated macroprudential council, but should instead be pooled in a powerful interagency council (Interview30, 2016) (Interview31, 2016) (Interview37, 2016) (Interview38, 2016).

The impasse was eventually broken by a proposal from the House for a weaker interagency council called the Financial Stability Oversight Committee (FSOC). Chaired by the Treasury Secretary, FSOC would bring together the existing regulatory agencies to provide aggregate

oversight, identify emerging systemic risks, share information, and designate individual firms as systemically important (Guha & Braithwaite, 2009) (Interview30, 2016) (Interview31, 2016) (Interview37, 2016) (Interview38, 2016). The Fed and Treasury were initially highly critical of FSOC because it risked dispersing responsibility and accountability for macroprudential policy-making across multiple institutions. Secretary Geithner was particularly scathing, claiming '*you can't convene a committee to put out a fire'* (Geithner 2014, p. 403). Yet its opposition gradually fell away as it became clear that the proposal had bipartisan support from Chris Dodd and Richard Shelby, the ranking Republican member of the Senate Banking Committee (Interview30, 2016) (Interview31, 2016) (Interview37, 2016) (Interview38, 2016).

The Obama Administration's plan for centralising macroprudential policy-making in the Fed was ultimately blocked by Congressional opposition. Yet this was fuelled in large part by lobbying from existing regulatory agencies whose position was threatened by the proposed changes. However, although bureaucratic resistance was sufficient to defend the pre-existing institutional division of labour, it could not prevent key Congressional actors from reaching political agreement on the creation of new, overlapping institutions. Hence, the solution that eventually emerged (FSOC) represented a form of institutional layering, overlaying the existing institutional architecture with a new structure to coordinate macroprudental oversight across myriad different agencies.

In the UK, important differences existed between the government and the central bank over the design of the powerful new committee for macroprudential policy-making. The Bank feared that the government would try to retain control over macroprudential policy objectives and instruments, which it could manipulate for electoral reasons. Above all, Bank officials' preferences were to ensure that the reforms would not compromise their

‘sacrosanct’ monetary policy capabilities and political independence. The Bank’s fears were confirmed when the Coalition government proposed the creation of a new Financial Policy Committee (FPC) to be chaired by the Chancellor. This stemmed from HM Treasury’s experience during the financial crisis, as officials blamed the Bank for being slow to respond (Darling, 2011, pp. 57-8) (Interview5, 2014) (Interview13, 2015). The proposed committee would serve as a powerful political constraint over the central bank, ensuring that the Chancellor would have the final word on prudential matters (Interview13, 2015) (Interview20, 2015).

The Bank viewed the Treasury-chaired FPC as a direct threat to its status and autonomy, and sought to leverage its enhanced authority to amend the proposals. It asserted that the delegation of macroprudential regulation should be based on ex post accountability; specifically, this meant that the new FPC should be modelled on the existing Monetary Policy Committee (MPC), with the Bank Governor as Chair. The Bank combined technical and political arguments to make its case. First, it suggested that its warnings about financial instability prior to the crisis had been largely ignored, and that only central banks had the necessary expertise to use the full range of new prudential policy levers appropriately (Interview13, 2015) (Interview6, 2014) (Interview5, 2014). Second, Bank officials warned of the tendency for elected politicians and other ‘non-experts’ to interfere (Treasury Committee 2011, p. 126). Its strongest argument was that denying full autonomy over the FPC may create the impression that its political independence had been compromised, which would send a dangerous signal to the markets (Interview13, 2015).

These claims proved difficult for the government to counter, and the relatively inexperienced Chancellor did not have the authority to face down the long-serving Governor (Treanor & Elliot, 2010) (Watt, 2012) (Jenkins & Murphy, 2010) (Interview5, 2014). The final

design of the FPC therefore emulated the MPC, enshrining a powerful financial stability mandate, which minimised the risk of future political interference. By exploiting its new monopoly on bureaucratic power, the Bank was able to partially subvert the government's original plans in order to protect its status and autonomy.

7.2.4 Micro prudential Supervision in the US and UK

During the election campaign, Obama made consolidation of financial regulatory agencies one of his main institutional reform priorities, arguing that fragmentation encouraged industry venue shopping and regulatory arbitrage. Based on its experience during the crisis, the Fed and the Treasury agreed that merging agencies was essential to reduce the risk of supervisory failures and to enhance the government's capacity to act decisively in a crisis (Interview30, 2016) (Interview40, 2016) (Interview37, 2016). Following the election, the new Administration proposed consolidating the OCC, FDIC and OTS into a single national regulator for depository institutions, and combining the CFTC and SEC under the Fed's authority. To increase the chances of securing bipartisan agreement in Congress, it also advocated removing the Fed's consumer protection role by creating a powerful new Consumer Financial Protection Bureau (CFPB) (Interview30, 2016) (Interview40, 2016).

The reforms soon ran into opposition in Congress and amongst other bureaux. The Senate Banking Committee supported the principle of consolidation, but its members were highly critical of the Fed's 'abysmal failure' in supervising banks prior to the crisis (Washington Post, 2009). To secure bipartisan backing, Senator Dodd calculated that it should be stripped of its micro prudential responsibilities altogether and put forward alternative proposals to consolidate bank supervision into a new Financial Institutions Regulatory Authority. This would result in the OCC and OTS being dissolved, while the supervisory role of the Fed and FDIC would be transferred to the new body.

The Fed responded robustly to this threat, arguing that bank supervision was central to the effective discharge of its core central banking capabilities (Interview30, 2016) (Interview31, 2016). Officials claimed that it was vital to have an 'on-site' supervisory presence within individual firms during the crisis, and that information on bank balance sheets was used to guide monetary policy decisions (Bernanke 2010, p. 7). To make its case, the central bank embarked on intensive lobbying of Congress. As a Fed official noted:

> '*We were asked to comment on the ideas of Congress…We had our chief goals and we weren't going to go up there [the Hill] devoting 90 per cent of our time to a battle that would have been lost'* (Interview40, 2016).

The Fed did at one point consider brokering a deal with Congress that would allow it to retain supervisory authority over systemically important institutions. This happened in March 2010. The agreement proposed limiting the Fed's supervisory role to systemically important holding companies with assets greater than $50 billion. Importantly this compromise would now also include all large non-bank financial institutions, such as AIG, to come under the Fed's purview (Felsenthal, Bernanke defends Fed small bank supervision role, 2010). As a consequence, responsibility for supervising more than 5,000 smaller community banks would have been removed from the Federal Reserve Bank System and handed to the FDIC and Office of the Comptroller of the Currency (Puzzanghera, 2010) (Felsenthal, Bernanke defends Fed small bank supervision role, 2010). Although this entailed the loss of a substantial capability, Fed Board members initially concluded that this was a necessary sacrifice in order to gain exclusive supervision of those institutions most likely to call on its LOLR facility and ensure it could discharge its new macroprudential responsibility effectively whilst protecting its monetary policy independence to the greatest possible extent (Interview40, 2016) (Interview34, 2016).

Neither the Fed nor the Senate had anticipated the large negative response from both community banks and the subsidiary Reserve Banks, however. For most Reserve Banks, community bank supervision was viewed as a high-status role and they traditionally enjoyed close relations with community banks.[21] In response, Reserve Bank presidents reacted angrily to the proposals from the Federal Reserve Board and set out to lobby Congress to force the Board's hand (Hoening, 2009) (Interview34, 2016) (Interview40, 2016).

Community banks argued that they had not caused the financial crisis and restricting the Fed's supervisory role could lead to a bias in favour of the largest financial institutions (Puzzanghera, 2010) (Interview11, 2016) (Interview30, 2016) (Interview31, 2016) (Interview40, 2016). These claims resonated particularly with Senate Republicans who were concerned that the removal of community bank supervision would jeopardise the dispersion of power within the Federal Reserve System resulting in an even more influential Federal Reserve Board in Washington DC (Interview39, 2016) (Interview40, 2016).

The Reserve Banks also pointed to their role in subduing the crisis by providing the Fed Board with information about the banks they supervised. As Bernanke had himself argued, the Federal Reserve's own supervisors were more knowledgeable and had greater bandwidth to supervise complex banking institutions.

The Fed Board recognised the internal disagreement between the Board and Reserve Banks was highly damaging to its ability to influence the wider package of financial regulatory reforms (Bernanke, 2015, pp. 459-461) (Interview38, 2016). The Fed Board therefore reversed its position and rejected the compromise with Congress. Instead the Fed put

[21] Each Reserve Bank has its own its own board of directors appointed in consultation with industry.

forward a robust defence that having a network of subsidiaries to supervise community banks provided valuable informational advantages (Bernanke, 2010c) (Felsenthal, 2010) (Interview34, 2016) (Interview38, 2016). (Interview40, 2016) (Bernanke, 2010b, p. 446). Senior Fed officials, past and present, were called upon to publicly cite the importance of maintaining a connection to 'Main Street' as well as to Wall Street, and that having a window into the activities of smaller banks was essential to the operation of monetary policy and preserving financial stability (Felsenthal, 2010). The outcome saw Congress back down and grant the Fed enhanced micro supervisory capabilities over non-bank firms, without losing any existing capability. The unanticipated opposition of the Reserve Banks and community banks was fortuitous for the Fed, in that it inadvertently strengthened its position.

Opposition to micro-regulatory consolidation also came from the other regulatory agencies. The head of FDIC, Sheila Bair, was relentless in defending their interests, proposing instead that the FDIC should be given greater powers to oversee resolution of large banks (Murphy, 2009). The FDIC feared a loss in status if it was left overseeing the resolution of non-systemic firms. The agencies sought to capitalise on mounting opposition to the consolidation proposal in Congress. This stemmed from the fact that, historically, many of them (such as the CFTC) came under the jurisdiction of congressional agriculture committees. Their members did not want to relinquish significant campaign contributions from industry, nor the status and profile they derived from holding financial regulators to account (Interview30, 2016) (Interview37, 2016). The bureaucratic resistance also brought the financial industry into the negotiation. The combination of bureaucratic, political and industry opposition was sufficient to defeat the rival proposals put forward by both the Obama Administration and the Senate. As a result, the pre-crisis supervisory architecture survived largely intact.

Once again, the Obama Administration's plans for strengthening the supervisory powers of the Federal Reserve was effectively vetoed by Congress, with the support of the other regulatory agencies and industry. However, unlike macroprudential regulation, it was not possible to circumvent Congressional and bureaucratic opposition by reaching a political agreement on the creation of new institutional structures. The failure to layer a new institution on top of the existing architecture in this instance reflected the fact that the debate about micro prudential reform concerned the location of existing supervisory powers, not the creation or coordination of new policy tools or instruments. As a result, all reform proposals threatened the bureaucratic 'turf' of at least one existing agency. This opposition was sufficient to ensure that there was no solution available.

7.2.5 Micro prudential supervision in the UK

Under the Coalition Government's proposals, supervision of all financial institutions would become a core function of the Bank of England, fully integrated into its central governance structures and with direct responsibility transferred to the Governor. This was deemed essential to ensure that monetary and macroprudential policy could be coordinated with the supervision of firms (Conservative Party 2009). Centralising macro- and micro prudential responsibility in the central bank was justified on the grounds that this would create a single point of accountability and strengthen regulators' capacity to respond flexibly to crises. In addition, delegating conduct regulation and consumer protection (which had been housed in the FSA) to a separate agency would help insulate banking supervision from political pressure.

The Bank of England made it known that it had serious concerns about having day-to-day supervision thrust upon it (Conaghan, 2012) (Interview13, 2015) (Interview5, 2014). Most of

all, it feared coming under external pressure from government and industry to use its new discretionary powers on capital to help struggling institutions. The Bank had also been scarred by the experience of major bank failures in the early 1990s and sought to insulate itself against this reputational risk. Governor, Mervyn King, believed that micro prudential issues should be kept as far away from the central bank's core responsibilities as possible; ideally, conducted by a separate entity, but one which the Bank would have the power to direct (Interview13, 2015) (Interview5, 2014). Recognising that the Coalition government had a clear mandate for reform, the Bank's leadership set out to try to remould its plans into something it could live with.

The institutional framework that emerged created two new bodies: the Prudential Regulation Authority (PRA), responsible for the prudential regulation and supervision of financial institutions; and the Financial Conduct Authority (FCA), which regulates financial products and consumer services. This differs from that originally envisaged by the government in two key respects. First, the Bank successfully resisted plans for supervision to be fully integrated into a core division of the central bank. Instead, this ended up housed in a separate subsidiary (the PRA) with its own legal personality and governance structure, ensuring that it would have full operational independence for day-to-day supervision and responsibility for firm-specific decisions (HM Treasury 2010: 29). By having the PRA at 'arm's length' from the central bank's traditional activities, the Governor was able to create a firewall between the two (Interview13, 2015). Second, the division of labour between the PRA and FCA has evolved in a way that is contrary to the government's intentions. The formal role of the new agencies is ambiguous: while the PRA has prudential responsibility for *'all deposit takers, insurers and significant investment firms'*, the FCA provides prudential supervision for any institutions 'not regulated by the PRA' (Bank of England 2013, p. 1). In

practice, however, the PRA solo prudentially regulates firms, while delegating prudential responsibility for supervision of the majority of firms to the FCA.

Central bank reform in the UK therefore met with little resistance from institutional or partisan veto possibilities, giving the new government a clear path to embark on institutional displacement by abolishing the tripartite system. In doing so, however, the government concentrated bureaucratic power in the hands of the central bank. Through its monopoly of technical knowledge and expertise, the Bank of England successfully reshaped the government's reforms in two key respects. First, the delegation of new macroprudential powers went further than the government had intended by handing responsibility to a powerful new committee, chaired by the Bank Governor. Second, the new arrangements represented an inelegant compromise which contradicted the government's own logic for scrapping the FSA; namely, to provide better coordination of macro- and micro prudential decision-making; and to separate supervision from conduct regulation. For this reason, I argue that central bank reform in the UK was also characterised by institutional subversion.

7.3 Assessment of propositions

What explains the variation in these cases? This thesis has considered this question from the perspective of international and domestic factors. Five propositions have been examined to explain how and why the institutional outcomes are observed. These are: institutional constraints; bureaucratic politics; political calculations of politicians; financial industry lobbying and the influence of a transnational epistemic community. The results of the case studies are summarised in the table below. The outcome of each observation is included in the final row.

Table 11: Assessment of propositions in each case study.

Explanations	USA		UK	
	Macroprudential	**Micro prudential**	**Macroprudential**	**Micro prudential**
Institutional constraints	Y	Y	Y	Y
Bureaucratic politics	Y (Diffuse)	Y (Diffuse)	Y (Concentrated)	Y (Concentrated)
Political explanations	M	M	M	M
Epistemic community	N	N	N	N
Financial sector lobbying	Y	Y	N	N
Institutional reform outcome	Layering	Layering	Subversion	Subversion

Key: Y=Yes; N=No; M=mixed

7.3.1 Impact of Institutional Constraints (P_1)

The first proposition highlighted in the literature review concerned the number of checks and balances imposed by the political institutions (Tsebelis 1999, 2002) (Gehlbach & Malesky, 2010) (Cox & McCubbins, 2001). Political systems characterised by federal systems, bicameral legislatures or higher party fractionalisation were expected to find it more difficult to pass radical institutional reforms, resulting in an outcome much closer to the status quo (layering). In contrast, those political systems with unicameral legislatures, or second legislatures that play a largely supportive function to the lower house, or strong party systems make it easy for the executive to push through its preferred legislation.

Both the US and UK cases provide support for the institutional constraint proposition. In the UK, once the Coalition Government was formed, it did not require further support or compromise with other political actors in order to guarantee legislative passage. When policies are included in general election manifestos or coalition agreements they are deemed binding given their popular support. As a result, the House of Lords played a largely supportive function to the lower house, removing any legislative veto points that could have prevented the executive from imposing its chosen institutional reforms. The lack of checks and balances in the UK made it easier for the government to force through institutional reform. In contrast, the USA is a federal system with highly independent bicameral legislatures, which creates numerous hurdles that must be overcome to approve regulatory institutional reform. The result was that multiple actors blocked the Administration's preferences for institutional reform. Political institutional constraints resulted in an additional negotiation on central bank independence in order for the macro and micro prudential reforms to survive. The result in the US case is that the institutional reform tends to resemble the status quo. These findings support the work of Bollard (1994), Goldfinch (2000) and Nagel (1998) who study economic reforms in countries with similar institutional constraints to those exhibited in the UK and US cases.

In terms of economic institutional constraints, both the Bank of England and Federal Reserve Board are independent central banks. They are instruments of government, but not controlled by government. What differs is the economic mandate of each central bank at the beginning of the institutional reform process. Of the two central banks, the Fed had the most far-reaching statutory mandate. It was responsible for monetary policy; micro-supervision; and financial conduct regulation. The Fed is directly accountable to Congress. By contrast at the time the reforms began the Bank of England had no responsibility for micro-supervision of the financial sector. The Bank's mandate was to set monetary policy

and it had a secondary objective to promote financial stability. The Bank is directly accountable to HM Treasury. The preference of each central bank was to protect the capabilities they had, especially monetary policy autonomy. Despite this each central bank had an overriding preference to preserve its monetary policy-making autonomy; the Bank and Fed put forward contrasting arguments and strategies to achieve the same high-level objective. The Fed argued that supervision was essential to its monetary policy and financial stability objectives. The Bank viewed micro prudential supervision of firms to be a hindrance to monetary policy decision-making (Bank of England, 2008, p. 226).

This thesis argues that institutional constraints enable actors' influence by *'loading the dice'* in favour of some groups at the expense of others (Underhill, 1994). Institutional constraints affect the incentives and costs facing actors in the institutional reform process. The effectiveness of actors in influencing policy is therefore dependent on the nature of existing institutional constraints. The institutional constraints often qualify the explanations tested. In the UK political institutions characterised by few checks and balances; that concentrated power in the hands of the executive; and offered limited veto possibilities, facilitated radical institutional reform by inadvertently empowering the Bank of England. The independent bicameral and weak party political institutions in the US largely contained the influence of the Fed by opening up the negotiations to a range of bureaucratic, industry and political actors. The institutional constraints presented significant obstacles to passing legislation and provided an incentive to produce institutional outcomes closer to the status quo.

Overall, the institutional constraints explanation provides a theoretical basis for the association between institutional outcomes and central bank reform. Yet, the institutional reforms undertaken in the UK and US were not done so on the basis of constitutional amendments. Rather they are done so through statutory instruments to legislation (the

Dodd-Frank Wall Street Reform Act 2010 and the Financial Services Act 2012). The consequence of this reveals the limitations of the institutional constraints proposition. That is that these institutional reforms can be repealed at any time if it is politically convenient to do so, thus we must jointly investigate institutional constraints with other explanatory factors such as bureaucratic politics, political explanations, financial industry lobbying or the diffusion of ideas and epistemic communities, in order to add to our understanding of the drivers of central bank institutional reform.

7.3.2 Impact of Bureaucratic Politics (P_2)

The second proposition argued that where bureaucratic power is concentrated, central banks are likely to wield greater influence over the institutional reforms, moulding them in line with their own preferences. Whereas, if bureaucratic power is diffused across multiple agencies, central banks will be less influential in shaping institutional reforms in line with their own preferences (Adolph 2013; Bendor *et al* 1985; Miller and Moe 1983; Niskanen 1971, Knill, 1999).

In both cases there is strong evidence that the bureaucratic politics explanation heavily influenced the design of the institutional reforms. The UK tripartite system of financial regulation in place at the outset of the financial crisis had three bureaucratic players. If the system had been maintained then bureaucratic competition would have continued irrespective of which political party was in power. By scrapping the tripartite system and handing prudential responsibility to the central bank, the UK Coalition Government concentrated bureaucratic power in the hands of a single bureau. The institutional constraints imposed by the Coalition Agreement removed the FSA's bargaining power, thereby allowing the Bank to negotiate in an environment of concentrated bureaucratic power. As predicted by the framework, this provided considerable scope for the central bank to reshape institutional reform. This sits in stark contrast to the Bank's influence when

the Labour government sought to initiate its own pre-crisis institutional reforms in October 2008. The Bank had been agnostic about taking on macroprudential authority until the point that the Labour government revealed a clear preference to empower the FSA with macroprudential authority in the UK. The turning point was once the Bank realised that another institution, other than the Chancellor, would have a significant role in the Bank deploying its LOLR capabilities. The Governor and the Bank's Court were concerned that the Bank would have to undertake operations based upon the analysis of non-Bank personnel at the FSA. This would have made the Bank the subordinate partner in the re-configured tripartite system. This was an unacceptable compromise for the Bank. In this environment of dispersed bureaucratic power the Bank found it more difficult to convince political principals of the need to empower the Bank with macroprudential capabilities.

The US case is more complex. It is difficult to isolate bureaucratic politics as the main driver of institutional outcomes. The US financial regulatory system is characterised by its byzantine structure. The Obama Administration's and Fed's plan for centralising macroprudential policy-making in the Fed was blocked by Congress, bolstered by the opposition of existing regulatory agencies whose position was threatened by the proposed changes. Sheila Bair, Chair of the FDIC, led the bureaucratic resistance insisting that the authority of other regulators should not be subordinate to a Fed-dominated macroprudential council, but should instead be pooled in a powerful interagency council (Interview31, 2016) (Interview32, 2016) (Interview37, 2016) (Interview38, 2016). The bureaucratic resistance also brought political resistance into the process. Disgruntled agencies seeking to protect their autonomy mobilised their political support to veto the Administration's preference. The financial services industry also sided with the regulatory bureaux. However, although bureaucratic resistance was a necessary condition to defend the pre-existing institutions, it could not prevent key Congressional actors from agreeing to

create new, overlapping structures. Hence, the solution that emerged (an inter-agency council) represented a form of layering, overlaying the existing institutional architecture with a new body to coordinate macroprudential oversight across different agencies.

When the Administration and the Senate Banking Committee proposed micro prudential consolidation, the bureaucratic mobilisation followed the same process. The combination of bureaucratic and industry opposition was sufficient to defeat the rival proposals put forward by both the Obama Administration and the Senate. As a result, the pre-crisis supervisory architecture survived largely intact. Where the bureaucratic authority was more concentrated the Fed was able to achieve its preferences or move the institutional outcome far closer to its preferences. This was the case in regard to consumer protection and central bank independence. In both negotiations the Federal Reserve became the only forceful bureaucratic institution seeking to influence the direction of reform. The debates around consumer protection and central bank independence were unique to the US. They were driven by political preferences and were essential in order for the macro and micro prudential institutional reforms to be passed.

In conclusion, bureaucratic politics was an important factor in both cases once the status quo institutional arrangements were threatened. However, the central banks were only able to exclusively influence the institutional outcomes under specific conditions. First, is an environment of concentrated bureaucratic authority. Second, when the financial industry lobby is weak, or not diametrically opposed to the central bank's preferences. If these conditions are satisfied then politicians must reach consensus with the central bank in order for institutional reform to take place. This finding is consistent with Allison's (1969) claim of that bureaucratic institutional reform: '*is not chosen as a solution but rather results from compromise, coalition, competition, and confusion among government officials who see*

different faces of an issue; political in the sense that the activity from which the outcomes emerge is best described as bargaining" (Allison G. 1969, p. 708). This inadvertently empowers the central bank with a veto (Allison & Halperin, 1972, p. 52).

The weakness of the bureaucratic politics explanation, as evidenced by the US case, is that it cannot adequately account for financial industry influence. Further, the bureaucratic politics explanation is qualified by the political explanation. For example, politicians must have an incentive to champion institutional reform in the first instance in order for bureaucratic politics to begin. Finally, the bureaucratic politics explanation without central bank expertise may not result the same institutional outcomes.

7.3.3 Impact of political explanations

The political proposition offers an explanation for institutional reform based upon the electoral incentives facing politicians. Politicians must see clear electoral gains from institutional reform that exceed the electoral costs in order to pursue it. This proposition received mixed support. It is clear that partisanship does not account for the institutional outcomes, as suggested by other studies including some on central bank reform (Alesina and Rosethal, 1995) (Garrett, 1998) (Quaglia, 2008b) (Way, 2000). Where the political proposition adds significant value to the institutional reform explanation is in the fact that political elites pursuing institutional reform is a direct result of preferences derived through political competition (Downs, 1957; Alesina, Spolaore, & Wacziarg, 1997; Lohmann, 1998; Avellaneda, 2013). This is true in both the US and UK. This finding supports the work of Downs (1957) and Wittman (1973) by confirming that political parties do not care about policies but more simplistically only care about gaining office (Wittman, 1973, p. 495) (Dunleavy, 1991, p. 118) (Roemer, 2001, p. 7). Thus the model could be refined to account for policy preferences of political elites seeking to propose the policy preference that best

maximises their party's utility (Wittman, 1973, p. 495) (Roemer, 2001, p. 7). This conclusion is discussed in more detail below.

First, the political preference formation for institutional reform is arguably most pronounced in the UK where an incumbent government was seeking re-election. In the UK the reasons provided by the Chancellor George Osborne for favouring institutional reform are clear, the crisis was to be used as a tool with which to discredit the incumbent Labour government. Indeed, the central bank governor commented that: *"Cameron and Osborne have a tendency to think about issues only in terms of politics and how they might affect Tory electorability"* (Wintour & Leigh, 2010). This process of timing of institutional reform, and the rationale for preference formation, in the UK supports the findings of King's (2005) study of 1997 Bank of England independence. Similarly, the Obama campaign successfully utilised financial institutional reform for electioneering purposes. In fact it is revealed as a pivotal moment that potentially altered the outcome of the November 2009 Presidential election (Holcomb, 2013). The political preferences of the new executives in the UK and US are important drivers of institutional reform. Central bank institutional reform would not have been on the policy agenda had it not been for the preferences of the two executives. These preferences were heavily grounded in political competition and were essential in triggering the bureaucratic politics and negotiations that followed. This implies that political preferences are an important element in explaining the institutional reforms that occurred (Wittman, 1973, p. 495).

Second, once negotiations begin political explanations retained relevance, though are heavily qualified by the institutional constraints faced. In the US, negotiations were characterised by on-going political incentives throughout the institutional reform process. Democrats were divided between different types of institutional reform. The Obama

Administration's plan for reforming the Fed met with stiff opposition from key Congressional leaders; largely Chris Dodd, Chairman of the Senate Banking Committee. As a counter proposal, Senator Dodd published a Bill recommending the creation of a new Agency for Financial Stability, headed by an independent chairman appointed by the President, in which all macroprudential powers would be located. The Dodd Bill also sought to strip the Federal Reserve, and other regulators, of their micro-supervisory capabilities. Dodd's political calculation was that radical reform that punished the central bank would be electorally beneficial. However, Dodd's resistance to the Administration and Fed's preferences fell away once he announced he would not be seeking re-election (Ferraro & Holland, 2010). Dodd's actions are consistent with accounts of political behaviour (Wittman, 1973; Downs, 1957). There was no such opposition to the UK government's institutional reforms from members of the Coalition Government political parties due to the strong party system.

However, there is a major shortfall in the political proposition as it is explained by the literature. It assumes that politicians conceive of institutional reform as a tool for electoral victory and then implement their preferences hierarchically in order to reap the electoral rewards in the future. Yet in the UK, the Coalition Government's agreed position was not successfully imposed upon the Bank. The Government backed down when confronted with central bank resistance. For example, HM Treasury was unsuccessful in gaining political control of the FPC. Second, all prudential regulation should have been moved across to the central bank and a new prudential regulation division would have been created with Hector Sants, FSA CEO, as Deputy Governor of Prudential Regulation (Bank of England, 2018). The FCA should have been limited to conduct regulation, yet it became the largest prudential regulator in Europe. The institutional outcome is far more blurred, with the FCA retaining large chunks of prudential regulatory responsibility. The PRA was created as a subsidiary of

the central bank. This in effect ensured that prudential regulation did not rank as highly as monetary policy objectives within the central bank.

In the US too, despite controlling the executive and legislature, the Administration was unable to impose its preferences for institutional reform. No political faction was able to dominate. First, the Fed should have been granted extensive new macroprudential powers as a member of the President's Working Group (Interview33, 2016) (Interview35, 2016) (Interview34, 2016). Second, significant regulatory consolidation with micro-supervisory responsibility should have occurred – either transferred to the Fed or a new prudential regulator. This resulted in political preferences being unable to entirely dominate the decision-making process.

Overall, the political proposition cannot be rejected and receives mixed support in this research. Both cases provide support for the proposition that politicians will not introduce institutional reform that they believe will impede their electoral chances (Alesina, Spolaore, & Wacziarg, 1997; Lohmann, 1998; Avellaneda, 2013; King M. 2005, p. 118). Indeed the existence of political preferences for institutional reform are critical to the outcome in the sense that their absence would have resulted in no institutional reform process being undertaken in either case. Political preferences directly triggered other actors. Institutional constraints and bureaucratic politics only influence the process once these preferences have been revealed. However, the ability of politicians once in power to successfully impose their preferences on the institutional reform outcome is far more limited.

7.3.4 Impact of Financial Industry Lobbying

The evidence that supervisory reform is the result of financial services lobbying is markedly different across both cases. The size and fiscal strength of the financial services lobby in

both the UK and US is significant. The US suffered a financial crisis of a similar magnitude to the UK. In the aftermath of the financial crisis and bank bailouts, public opinion firmly opposed concessions for large banks in both cases. In the UK there is no evidence that banks were able to influence the institutional reform. In contrast, the US case reveals that large banks were not able to influence the institutional reform, but smaller community banks held significant influence over the institutional outcomes.

The lack of effectiveness of the financial industry in the UK and of large banks in the US is not surprising. The US banking sector is split amongst a diverse group of firms that can have different preferences regarding the same policy issues (Woll, 2014, p. 83). For example, macroprudential policy tools may only be of importance to the largest firms, yet the architecture impacts all firms. In contrast 6 large firms dominate the UK banking landscape. Moran (1986) may explain the lack of large bank influence by pointing the fact that when significant structural changes are looming, in this case potential changes to capital and liquidity standards or the prospect of separation of retail and investment banking, large firms tend to save their lobbying capacity for the issues that directly impact their profitability (Moran 1986, p. 189).

This thesis suggests that the impact of public opinion made politicians significantly less responsive to industry concerns about altering the regulatory architecture. Individual politicians in the UK are not reliant on raising individual campaign funds and therefore are less directly beholden to business interests. In addition, the Conservative Party in opposition had argued its institutional reform would end the closeness between regulators and industry. Having been locked out of government since 1997, the optics of siding with the financial industry over public opinion was not have been a rational choice for Chancellor

Osborne. As a result the industry was locked out of the reform process beyond submitting written consultation responses to HM Treasury.

Yet in the US, despite public opinion on large banks being similar to that in the UK, the process reveals far more politicians made concessions in response to industry lobbying. This is consistent with the findings of recent studies into post-financial crisis politics (Bell and Hindmoor 2015; Carpenter 2010; Culpepper and Reinke 2014; Jacobs and King 2016; Zeigler and Woolley 2016). This occurred when the factional banking sector in the US was coordinated in its opposition to macro and micro prudential institutional reforms proposed by the Administration and Senator Dodd, albeit for differing reasons. For example, smaller banks feared an unlevelled playing field in which policymakers focused on the largest firms to the detriment of competition in the banking sector. However, when the largest banks were isolated in their lobbying, their influence significantly reduced. In contrast smaller banks remained influential, even when isolated. For example, this happened during the consumer protection negotiation when Barney Frank was able to carve out smaller banks from the purview of the new CFPB in July 2009 (Kus, 2016, p. 11). The consequence of Frank's intervention was that smaller banks removed their opposition to the creation of the CFPB. This paved the way for Democrats to vote for the CFPB without fear of harming economic prospects within their districts. In effect this saved the macro and micro prudential reforms. Therefore, this thesis suggests that within the US case smaller banks retained influence after the crisis. The finding in the US case is compatible with Lindblom (1977), who argues business holds a privileged position due to its control of investment and employment, both valuable resources that impact the popularity and success of politicians. Smaller community banks are responsible for significant economic activity within congressional districts. Furthermore this finding of bank coordination being essential for larger banks to gain their preferences is similar to a study on the structural power and bank

bailouts, in which a lack of coordination amongst banks results in government having to bailout failing institutions (Woll, 2014).

In conclusion, much of the variation in the US institutional reform outcome is a result of action or inaction by the community bank lobbying. These firms wished to remain under the supervision of the Federal Reserve and were able to exercise influence at important junctures in the process. Yet the source of this influence appears to be less of a financial resource for politicians, but it points towards more structural power resources (Lindblom, 1977). For example, community banks are responsible for a significant amount of economic prosperity within congressional districts. The findings in relation to financial services lobbying should be qualified by an acknowledgment that interviewees may have under or over represented the extent of financial industry lobbying in each case.

7.3.5 Impact of Diffusion of Ideas and Epistemic Community

The final proposition tested in this thesis argues that politicians are influenced into granting supervisory reform in response to ideas promoted by a transnational epistemic community of regulatory experts. Hass (1992) suggests four characteristics should be present to confirm an epistemic community of experts at work. First, "*a shared set of normative and principled beliefs"* that serves as rationale for action of community members (Haas P. M., 1992, p. 3). Second, *"shared causal beliefs"* which represent the communities account of why a problem arises (Haas P. M., 1992, p. 3). Third, *"shared notions of validity"* (Haas P. M., 1992, p. 3). Fourth, a *"common policy enterprise"* which is a set of *"common practices associated with a set of problems to which their professional competence is directed"* (Haas P. M., 1992, p. 3).

There is no evidence that suggests micro prudential institutional reform was the result of an epistemic community promoting any ideas. The evidence for this claim is that different

types of agencies in each jurisdiction conduct micro supervision across the UK, Eurozone and USA. There have been no publications on the best institutional design for micro supervision by the BIS. In both the US and UK cases there is evidence that ideas promoted by an epistemic community of macroprudential experts were taken up by domestic regulators. In the UK this was actually taken up by Lord Turner, chair of the FSA, whilst in the US Bernanke, the Fed chair underwent macroprudential conversion early on in the process. Ultimately, both the Bank and Fed advocated for macroprudential authority at various junctures during their domestic reform negotiations. Thus it could be argued that an epistemic community may have influenced the timing of macroprudential reform, but not the architecture.

For the epistemic community explanation to be accepted the evidence in the UK and US should follow the four stages that Hass (1992) defines as epistemic community characteristics. Further, for the architecture to have been successfully influenced by an epistemic community of regulatory experts we would expect to see isomorphism in the macroprudential institutional outcomes across both cases (Andrews 1994; Cukierman 1994; Maxfield 1997; Strange 1996; Williamson 1993; Winters 1994; McNamara 2002). Yet there is significant variation in the institutional outcome across both cases. The financial crisis certainly gave macroprudential policy an extraordinary boost (Borio, 2009, p.32). This happened in the US and the UK. Yet, as Borio has pointed out, '*a decade ago the term macroprudential was barely used and there was little appetite amongst policy makers and regulators to even engage with the concept, let alone strengthen macroprudential regulation'* (Borio, 2009, p.32) (Baker, The New Political Economy of the Macroprudential Ideational Shift, 2013). The Fed actively derided macroprudential ideas in the decade prior to the crisis (Goodhart L. M., 2014, p. 6) (Baker, 2013, p. 119) (Greenspan, 1999). In both the US and UK, the decade preceding the crisis provided no incentive to adopt macroprudential ideas because there was no incentive to alter the financial regulatory

framework. Economic growth continued unabated in the decade preceding the financial crisis. As this research highlights, pressure to alter institutional arrangements tends to only happen after a crisis event (Brändström & Kuipers, 2003) (Drennan & McConnell, 2007) (Boin, McConnell, & 't Hart, 2008).

Both the Fed and Bank adopted macroprudential policy in response to prevailing domestic conditions rather than due to the influence of or shared belief with an epistemic community. An epistemic community's technical expertise did not *'influence the conceptual framework'* in which the policy processes were embedded (Antoniades, 2003, p. 30). Yet macroprudential ideas were used as strategic *'weapons'* by central banks (Blyth, 2001; Chwieroth, 2010; Finnemore & Sikkink, 1998; Yee, 1996).

In the US, the Fed did not express an interest in macroprudential supervision until after the collapse of Leman Brothers on 15 September 2008. It provided the Fed with an opportunity to point to a missing piece of a regulatory toolkit that Congress had not empowered it with. The Obama Administration agreed with introducing macroprudential policy because it represented an opportunity for a symbolic break from the past and '*promised to limit future potential market losses, to reduce future calls on public finances'* (Baker, 2013). It was a political opportunity rather than the result of influence from an epistemic community. The extent of the crisis did result in space for policy entrepreneurs to promote their ideas directly to politicians. However, it was the Fed's strategic conversion to the macroprudential cause rather than an epistemic community that ultimately resulted in the new Administration unveiling a plan for macroprudential institutional reform. It was the central bank that set the Administration's preferences as it seconded employees to draft the White Paper. In addition the Treasury Secretary was an ex-central bank President and retained enormous faith in the Fed's expertise and advisory capacity.

The process was similar in the UK. Preference changes on macroprudential supervision followed the collapse of RBS. The incumbent Labour government tasked the FSA with producing a report on the future of UK banking regulation. Adair Turner, the newly appointed Chair of the FSA, conducted the report. The report recommended that the Bank of England and the FSA should be '*extensively and collaboratively involved in macroprudential analysis and the identification of policy steps. Measures such as counter-cyclical capital and liquidity requirements should be used to offset these risks'* (Turner, 2009). The incumbent Labour government wished to empower the FSA with macroprudential capabilities, whist the Conservative party wished to empower the Bank. It was at this point that the Bank confronted the prospect of macroprudential policy. It did not want its monetary policy autonomy to be subordinate to macroprudential authority located within a rival bureau.

Crucially, an epistemic community was not directly responsible in influencing the precise institutional architecture through which macroprudential policy was eventually discharged in the US or UK. Proponents of macroprudential supervision in the UK did not reach a consensus on a lead agency to discharge macroprudential policy. Similarly, in the US all actors bought into the idea of macroprudential supervision, but differed in their architectural preferences. For both central banks the conversion to macroprudential supervision was a strategic choice designed to protect existing autonomy. This decision would have been unnecessary in the absence of the collapse of major financial institutions. This failure of the epistemic community to influence the institutional architecture may be explained by two factors. First, a lack of consensus among the epistemic community on the precise architecture; and, second, the lukewarm reception that macroprudential ideas had previously received from central bankers themselves.

The way in which expertise actually influenced the outcome of the institutional reform in both cases was not through a shared belief amongst an epistemic community of experts, but rather as a power resource that allowed the central banks to steer political principals towards an outcome that was closer to their preferences. For the Bank this meant and FPC that was subordinate to the MPC. Whilst in the US this was achieved through the Fed gaining macroprudential decision-making autonomy once a council of inter-agency regulators had designated a firm as systemically important.

7.4 Central bank reform and actor influence

Throughout the negotiations each central bank was able to exert influence over the eventual outcome. This is evidenced in the process, referenced by interviews and survey data. In both cases studies actors referenced the importance of expertise in influencing the institutional outcomes.

This research has revealed all actors in the process perceived the US and UK central banks to possess high levels of technical expertise in the fields of macro and microeconomics, relative to other actors. This is consistent with Carpenter's (2001) prediction that there can be a link between independent bureaux and expertise (Carpenter, 2001, p. 5). Both the Fed and Bank are autonomous institutions within their polities. In addition, central bank officials have direct access to senior politicians and Treasury officials. The Bank of England used this line of communication to emphasise its credibility and expertise at the highest level during the negations with HM Treasury. For example, the Governor wrote directly to the Chancellor to settle working level disagreements on occasions when HM Treasury defied the Bank's preferences (Interview5, 2014).

The Federal Reserve benefits from similar levels of access to senior politicians, but the nature of the central bank's relationship with the Administration is markedly different. For example, the Fed co-authored the Administration's institutional reforms and the Treasury Secretary was a former Fed employee. In this sense the Fed is able to successfully influence the broad contours of the institutional reform from its earliest point. Whilst other bureaucratic actors were able to muster political influence, none had the ear of the Administration to the extent of the Fed.

What differs markedly is the perception of the Treasury department expertise in the US and UK case studies. In the US the Treasury department is considered to have strong expertise on the issue of financial regulation, for example via the Comptroller of the Currency, which is housed within the Treasury. Though technically independent, the Treasury is frequently able to draw upon its expertise. That said, the source of Treasury expertise on central bank reform in large part also stems from the Treasury Secretary and Assistant Secretary being appointed directly from the central bank or academia.

The perception of the UK's HM Treasury expertise is diametrically opposed to that of its US counter-part. This was crucial when the Bank was negotiating the outcome with HM Treasury. HM Treasury is considered as lacking technical expertise at working level. The process revealed both HM Treasury and the Bank were aware of this and it hung over the negotiations, having an impact on the direction of the outcome in favour of the Bank.
The behaviour of central banks when in deploying their expertise to influence negotiations fits the pattern of that theorised by Krosnick (1990). First, throughout each case study the central banks viewed institutional reform as part of larger pattern of how central bank autonomy could be impacted (Krosnick, 1990, p. 3). Autonomy and its impact on the quality of decision-making were paramount in the central banks' negotiation strategies. For

example, both central banks' preference was to protect the highly prestigious monetary policy-making capability from political interference. Each decision of the Fed and Bank can be traced back to this preference. In contrast those considered as non-experts (financial industry, politicians, or other bureaux) tended to view the institutional reform in isolation, in terms of instant loss or gain (Krosnick, 1990, p. 3). They tended not to link the issues of macroprudential, micro prudential and monetary policy in the sophisticated manner of the Bank or Fed.

Second, both central banks adopted more analytical approaches to macro and micro prudential institutional reforms. Examples of this include the Fed's 11-page analytical argument for retaining micro supervisory capabilities and empowering it with macroprudential responsibility (Bernanke, 2010f). Similarly, the Bank engaged in internal challenge about the impact of taking on macroprudential responsibility in order to ascertain whether the Bank could cope with the additional workload. In contrast rival bureaux in the US case could not answer the question of which institution should actually supervise systemically risky firms or what a prudent micro supervisory arrangement should look like. In both cases politicians remained reliant on technical support from the central banks on how macro and micro prudential institutional reform would impact monetary policy. In effect, non-experts were largely unable to develop strategies without thinking through the technical consequences or impact (Krosnick, 1990, p. 3).

Third, Krosnick also suggest that a trait of experts is that they are able to judge when decisions need to be re-considered, as a result of experts possessing greater self-awareness (Krosnick, 1990, p. 3). Both central banks did change their positions, in effect reversing previous decisions, through their conversion to the macroprudential cause. For the Fed this came early after the collapse of Lehman, Merill Lynch and AIG; and again following the

revolt of Reserve Banks and community banks on the loss of micro supervision. In the UK case, this change came later in the process, mid way through 2008, when the Bank began to advocate for macroprudential empowerment. This was a capability it had previously not considered prestigious. Further, once the political decision had been taken that the Bank would have to take on supervisory activity, the Bank recognised that it could not continue to argue against this. Instead it sought to alter the government's preferences to an institutional arrangement that the Bank could tolerate.

As the analysis of propositions reveals, other actors were also able to exert important influence over the institutional reform in the US. However, the ability of these other actors to exercise influence over the institutional reform process is heavily qualified by the political institutional constraints. The effect of the high levels of political institutional constraints and diffuse bureaucratic authority restricts the impact of central banks' influence. Yet as the US case highlights, it does not remove it altogether. The Federal Reserve was still able to protect its key preferences through an institutional outcome characterised by layering. Ultimately, government still believes it must rely on the expertise of the central bank. Whereas in an environment characterised by few political institutional constraints and concentrated bureaucratic authority, the Bank was able to exercise subversive power to great effect. This finding is given greater credence, given that the same propositions were tested in an environment where the Fed operated with fewer veto players and concentrated bureaucratic authority (central bank independence and consumer protection). The outcome here conforms to the subversion prediction. I contend that central banks' ability to influence the process does not stem from economic institutional constraints, but rather from the perception of technical expertise, qualified by political institutional constraints.

7.5 Conclusion

The analysis of variation in central bank reform since the financial crisis is surprisingly under-developed. The ambition of this thesis was to explain the strengthening of Western advanced economy central banks with new prudential powers. This thesis addresses this by conducting a comparative analysis of two cases that control for a variety of potential sources of institutional variation, such as the size of the financial sector; the impact of the crisis; and changes of government. Despite these similarities, the outcome of reform reveals substantial variation. In the US, the Obama Administration's plans for centralising prudential powers and consolidating supervision in the Federal Reserve were thwarted, forcing it to leave the existing architecture largely in place and to create a new institution to provide macroprudential oversight. By contrast, the UK reforms went further than the government's initial plans, handing the Bank of England control of macroprudential policy-making, but allowing it to delegate micro prudential supervision to subordinate agencies.

To explain this variation, I argue that it is essential to locate the analysis of central bank reform within its domestic political institutional context. Drawing on theories of institutional change and administrative reform capacity, a framework is developed to explain how shared external pressures for change (from the financial crisis), and common reform objectives (to grant central banks new prudential powers), produced divergent institutional outcomes in different national contexts.

The research suggests that two institutional variables serve as the important sources of variation: Institutional constraints (high or low veto possibilities) and bureaucratic structures (concentrated or diffuse power). The two cases are characterised by important differences with respect to both variables. In the case of the US, high veto possibilities resulting from the veto power wielded by Congress made agreement on institutional reform much more

difficult to achieve, effectively thwarting the Obama Administration's initial plans for strengthening the prudential powers of the Federal Reserve. At the bureaucratic level, the diffusion of responsibility for financial regulation and supervision across multiple agencies created a further barrier to reform as each agency sought to jealously guard its bureaucratic turf. However, these agencies lacked the capacity to resist institutional layering through the creation of new agencies. In addition, the political institutional constraints in the US provided opportunities for the financial services lobby to influence the process. To circumvent opposition to macroprudential reform, the Administration therefore reluctantly agreed to the creation of a new body (FSOC) to coordinate the activities of existing regulators. By contrast, in the case of the UK, low veto possibilities arising from the Coalition Government's parliamentary majority provided few obstacles to implementing the Conservative Party's plan for institutional displacement by abolishing the FSA and centralising prudential policy-making in the Bank of England. However, by concentrating bureaucratic power in a single agency, the institutional changes gave the Bank considerable scope to shape the details of the reforms to further its own interests. This process of subversion produced a form of central bank reform that was significantly at odds with the government's original intentions.

7.5.1 Contribution to the literature

This thesis has considered the relevant importance attributed to international and domestic factors when determining central bank institutional reform. This thesis seeks to make a broader contribution to the literature on administrative reform in several ways. First, it aims to show how theories of institutional change can be used to 'bring the politics back in' to the analysis of administrative reform – in this instance, central banks – in different national contexts (for example, see Bezes 2001, 2007; Parrado 2008; Ongaro 2009; Meyer-Sahling and Yesilkagit 2011; Bezes and Lodge 2015). These approaches are well placed to

endogenise the drivers of change by explaining how external pressures, such as the financial crisis, are mediated and refracted by powerful domestic actors. In addition to highlighting the critical role of veto players, the explanation emphasises how powerful bureaucratic actors – including central banks and other regulatory agencies – also seek to mould and steer administrative reform to further their own organisational interests. In this way, this thesis stresses the causal importance of the domestic political-bureaucratic context and helps to bridge the divide between the fields of public administration and executive politics (Lodge & Wegrich, 2012).

Second, it adds to the bureaucratic politics literature that suggests public agencies use administrative reform to advance their policy goals (Durant 2008; Gains 2003). It challenges the basic budget-maximising assumption that bureaucrats, without a carefully designed incentive structure, will act in their short-term self-interest and may work to inflate the budgets of their bureaux (Niskanen 1971). It also challenges Dunleavy's (1991) premise that bureaucrats prefer an affable policy advice role close to core political elites. In contrast this research highlights that bureaucratic actors, in this case central banks, place great value on autonomy and distance from political elites. These arguments can be linked to a literature that goes back to Downs (1967) and suggests that bureaucrats display a varied range of job preferences that relate to their preferred job task (Brehm and Gates 1997; Brewer and Maranto 2000).

The institutional approach provides a more nuanced perspective on administrative reform capacity (Knill 1999, 2005). Rather than simply assuming that bureaucratic power and autonomy serve as a constraint on the will of political actors to implement administrative reform, this thesis suggests that the effect of bureaucratic power can be to both facilitate and constrain institutional change depending on how it is structured. For example, in the US

bureaucratic fragmentation served as an obstacle to reform as competing regulatory agencies rallied support amongst political allies in Congress to defend the status quo. By contrast, in the UK bureaucratic concentration facilitated reform as the central bank lobbied the government to go further than it had originally intended in its delegation of new macroprudential powers. An institutional perspective therefore points to how political and bureaucratic opportunity structures generate distinct modes of institutional change. Analysed in this way, the thesis highlights how administrative reform capacity is not binary (i.e. high or low) but multi-dimensional, capable of producing subtle forms of change in the face of multiple veto points (e.g. layering), as well as generating new or unintended reforms even when political actors face few obstacles (e.g. subversion).

Contrary to many studies that investigate the role of financial industry lobbying during the financial crisis (see Bell and Hindmoor 2015; Carpenter 2010; Culpepper and Reinke 2014; Jacobs and King 2016; Zeigler and Woolley 2016), this thesis does not find the large banks were influential in shaping post-crisis institutional reforms. Rather, this finding is more closely aligned with Woll's (2014) work in that it points towards the importance of coordination amongst banks as critical to influencing decisions. This thesis suggests that in the wake of the financial crisis, large banks in both the UK and US were too weak to influence the direction of institutional reform. This was despite the largest banks throwing considerable resource behind their lobbying efforts. This is particularly true in the US case; where many of the outcomes of the institutional reform on macroprudential and micro prudential reform were dependent on the positions adopted by smaller community banks.

The thesis confirms that negotiating institutional reform is ultimately reliant on one actor making use of its advantage, for example informational power or perception of power and expertise (Allison & Halperin, 1972, p. 52). This thesis reveals that central banks enjoy an

enormous bureaucratic advantage in this respect. Central banks' technical expertise is the source of this advantage. Central bank expertise restricts politicians' ability to pursue their preferences for central bank institutional reform when political preferences are diametrically opposed to those of the central banks. Jacobs and King (2016) suggest that the Fed believes that *'its technocratic experts know best'* and that the *'allure of expert rule swells during turmoil'* (Jacobs & King, 2016, pp. 10-11). They argue that Fed expertise in particular is a *'mirage'* (Jacobs & King, 2016, pp. 11-17). This research delves far deeper into the importance of technocratic expertise. The role of bureaucratic expertise is the main contribution of this thesis. Both cases confirm that both central banks have great faith in their expertise, yet also reveal that relatively few political actors feel sufficiently empowered to meaningfully challenge a central bank's technical arguments. In both cases, government implicitly accepts the role of central banks as expert advisers and therefore aids central banks in achieving their institutional reform preferences. This finding is consistent with Max Weber's ideal type of bureaucracy and its central notions of formal rationality, expert knowledge or impersonal authority (Weber 1958). This resource of expertise becomes even more important in complex areas such as macroprudential and micro prudential regulation. Central banks control of information relevant to regulatory reform puts them in a powerful position relative to politicians.

7.5.2 Future Research

Future research would do well to explore how these modes of institutional reform potentially give rise to national varieties of central bank reform over time. A primary candidate for the application of this theoretical approach is the establishment of the Single Supervisory Mechanism in the Eurozone. This was the post-crisis institutional framework that granted the European Central Bank (ECB) exclusive supervisory authority over all Eurozone member states banks. The ECB is one of the most important central banks in

world, as are the Federal Reserve and Bank of England. It is reasonable to assume, based on the finding of this thesis, that the ECB would have encountered bureaucratic politics within complex institutional constraints throughout this reform process.

Similarly, the framework could be applied to the case of the Swiss National Bank (SNB). Though not of the same magnitude, Switzerland did experience a banking shock in 2008. The result has not seen an expansion of SNB capability. Supervision remains with a government agency. In a deal coordinated by ministers, the SNB and federal banking commission, $60bn was injected into private banks, taking $50bn of toxic assets into the SNB balance sheet (Gow, 2008). Swiss banks are subject to the regulatory laws of the domains in which they operate. For example in the EU, but the state has no say in setting these rules.

In addition, since the institutional reform studied by this thesis was completed, the Bank of England has undergone a further round of institutional reform. One of the key features of this 2016 institutional reform was its ending of the subsidiary status of the PRA by bringing micro prudential regulation of financial institutions into the scope of the Bank of England through the establishment of a new Prudential Regulation Committee (PRC) to replace the PRA Board (Bank of England, 2017). The institutional reforms change the statutory basis of the FPC (first established in 2011) meaning that the setting of the Bank's financial stability strategy is transferred from the Court of Directors to the Bank itself. The 2016 institutional reform places the FPC on equal footing with the Bank's MPC and the new PRC. It was suggested that the purpose is to help better harmonise the conflicts around monetary policy and financial stability. This institutional reform followed the 2015 general election victory for the Conservative Party that allowed it to form a majority government. It also occurred following a change in Governor and senior leadership at the Bank. In the USA numerous

attempts have been made to repeal the Dodd-Frank institutional reforms over the past 3 years. Again, this follows changes in political and central bank leadership.

Finally, it is worth considering the extent to which the findings of this research can be extrapolated to other areas of regulatory reform. A crisis does not determine the exact architecture of institutional reform. Instead it is determined by domestic politics and constrained by existing institutions (Williamson & Haggard, 1993). Whilst in both cases examined in this thesis there are similarities in the institutional reforms, the differences are starker. For example, the inability of the Obama Administration to achieve its preferences on macro and micro prudential reform is explained by the different influence of domestic groups, such as bureaucratic and financial industry actors. In contrast domestic groups such as the financial industry lobby were far less influential in the UK, whilst bureaucratic influence was concentrated. The key point to be made is that the contents of these institutional reforms were dictated by domestic factors in these two states, not by international forces. The conclusion is that domestic politics continues to matter, particularly when it comes to the content and timing of domestic institutional reforms. The nature of institutional constraints and bureaucratic contestation are not limited to central bank reform. The framework may well be applicable to other types of post-crisis public sector institutional reforms.

Appendix: List of Interviews Conducted

Interview 1. (2014, November 3). Interview with Joint Committee Member. (H. Hungin, Interviewer)

Interview 2. (2014, November 6). Interview with Former Chair of Council of Economic Advisers; Head of Number 10 Policy Unit; HMT Official. (H. Hungin, Interviewer)

Interview 3. (2014, November 7). Interview with political advisor to Shadow Chancellor. (H. Hungin, Interviewer)

Interview 4. (2014, November 12). Interview with former banker, Number 10 adviser and economic historian. (H. Hungin, Interviewer)

Interview 5. (2014, November 14). Interview with Former Director-General, Financial Services HMT and private banker. (H. Hungin, Interviewer)

Interview 6. (2014, November 19). Interview with senior Bank of England official. (H. Hungin, Interviewer)

Interview 7. (2014, November 27). Interview with Head of Policy & Public Affairs, Private Bank.

Interview 8. (2015, January 20). Interview with Head of Policy, Private Bank. (H. Hungin, Interviewer)

Interview 9. (2014, December 10). Interview with Head of External Affairs, Private Bank. (H. S. Hungin, Interviewer)

Interview 10. (2014, November 19). Interview with Head of Public Policy, Private Bank. (H. Hungin, Interviewer)

Interview 11. (2014, November 10). Interview with Former Private Secretary to Governor of Bank of England. (H. Hungin, Interviewer)

Interview 12. (2014, November 13). Interview with Private Bank. (H. S. Hungin, Interviewer)

Interview 13. (2015, January 21). Interview with central bank official. (H. Hungin, Interviewer)

Interview 14. (2015, January 30). Interview with HMT Official (Special Resolution Unit). (H. Hungin, Interviewer)

Interview 15. (2015, January 23). Interview with central bank official. (H. Hungin, Interviewer)

Interview 16. (2015, February 10). Interview with Financial Commentator, Observor. (H. Hungin, Interviewer)

Interview 17. (2015, February 14). Interview with HMT official. (H. Hungin, Interviewer)

Interview 18. (2015, March 5). Interview with private bank. (H. Hungin, Interviewer)

Interview 19. (2015, March 5). Interview with private bank. (H. Hungin, Interviewer)

Interview 20. (2015, July 24). Interview with senior HMT offical. (H. Hungin, Interviewer)

Interview 21. (2015, September 26). Interview with FSA official. (H. Hungin, Interviewer)

Interview 22. (2015, November 6). Interview with FSA official. (H. Hungin, Interviewer)

Interview 23. (2016, April 22). Interview with central banker. (H. Hungin, Interviewer)

Interview 24. (2016, April 22). Interview with central banker. (H. Hungin, Interviewer)

Interview 25 (2016, April 22). Interview with central banker. (H. Hungin, Interviewer)

Interview 26. (2016, April 22). Interview with central banker. (H. Hungin, Interviewer)

Interview 27. (2016, April 22). Interview with central banker. (H. Hungin, Interviewer)

Interview 28. (2016, April 22). Interview with central banker. (H. Hungin, Interviewer)

Interview 29. (2016, February 19). Interview with Fed Board official. (H. Hungin, Interviewer)

Interview 30. (2016, March 1). Interview with senior Fed official (H. Hungin, Interviewer)

Interview 31. (2016, March 1). Interview with senior adviser US Treasury Dept. (H. Hungin, Interviewer)

Interview 32. (2016, March 22). Interview with congressional political adviser. (H. Hungin, Interviewer)

Interview 33. (2016, March 29). Interview with US commercial banker. (H. Harpal, Interviewer)

Interview 34. (2016, April 4). Interview with Fed official. (H. Hungin, Interviewer)

Interview 35. (2016, April 5). Interview with senior adviser CFPB and former senior Treasury Dept official. (H. Hungin, Interviewer)

Interview 36. (2016, March 7). Interview with Fed official. (H. Hungin, Interviewer)

Interview 37. (2016, April 12). Interview with CFPB offical and former Treasury Dept. official. (H. Hungin, Interviewer)

Interview 38. (2016, April 21). Interview with senior Fed Board official. (H. Hungin, Interviewer)

Interview 39. (2016, June 7). Interview with senior US Treasury Dept official. (H. Hungin, Interviewer)

Interview 40. (2016, May 4). Interview with Fed official. (H. Hungin, Interviewer)

Interview 41. (2017, Jan 12). Interview with former senior central bank official. (H. Hungin, Interviewer)

Interview 42. (2017, Jan 12). Interview with central bank official. (H. Hungin, Interviewer)

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