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Introduction

The story of the global financial crisis of the late 2000s is by now a familiar one. A minor decline in US housing prices sparked a crisis in the mortgage market that ignited a disaster that threatened to bring down the global financial system. As interest rates rose and property values started to drop in 2006, overextended borrowers struggled to refinance or keep up with their mortgage payments, and a wave of foreclosures followed. This unexpected increase in failed mortgages was bad enough, since financial institutions always struggle when more borrowers than expected fail to repay their loans. Yet recent developments in the financial system amplified the problem.

In the decades leading up to the crisis, banks had leaned hard into creating, trading, and holding new financial instruments derived from mortgages or other kinds of debt. As mortgage defaults rose, the value of financial instruments that used mortgage assets as their building blocks plummeted. These dynamics stoked panic. The complexity of the new financial instruments made it hard for investors to determine if they were worth anything. Their opaque structure also made it difficult for market participants to determine exactly how much exposure an individual financial institution had to the underlying risks. Nervous investors scrambled to offload all but the most transparent investments during the crisis, depressing the value of even complex and opaque financial instruments that incorporated few or no mortgage assets. Banks that held these securities suffered big losses. Investors responded by withdrawing their funds from banks, while banks stopped lending to one another. This set off a vicious cycle in which a rising tide of bank losses encouraged investors to further restrict the flow of resources to banks, which only amplified their financial distress.

As the housing crisis transformed into a banking crisis, deep interconnections between banks also transformed what was initially a crisis limited to the United States into a truly global event. Since banks borrow from other banks around the world, market disruptions in one country can easily spark a global liquidity crunch. And since banks also compete in an increasingly global marketplace, bankers face strong pressures to follow their international peers into innovative and risky (but potentially lucrative) strategies. Indeed, in the decade leading up to the crisis, banks from many of the world's other major financial capitals followed their American counterparts in making heavier use of complex and opaque financial instruments, including new forms of asset securitization and financial derivatives. Sometimes, these banks created, traded, or held securities that used US mortgages as their building blocks. Other times, these securities incorporated assets generated closer to home. Both strategies led to losses for banks when the global markets for these financial instruments collapsed in 2007 and 2008. To resolve the severe financial crisis that followed, governments were forced to intervene in financial markets on an unprecedented scale. Many countries, borrowers, and households have yet to recover from the economic blows they experienced in this period.[1]

Given the devastating economic and social impacts of the global financial crisis, it is no surprise that this event has attracted a great deal of scholarly interest. Scholars continue to debate the relative impact of factors that contributed to the emergence of an asset price bubble in the US housing market, including historically low interest rates, global trade imbalances, lax lending practices, government support to housing, and the rising popularity of mortgage securitization.[2] A large body of research has also examined the causes and consequences of the uptake of the complex financial innovations that exponentially increased bank exposure to mortgage performance.[3] More recently, scholars have linked many of the risky behaviors that featured in the crisis to changes in bank corporate governance arrangements, showing how the rise of a new model of management, the shareholder value model, gave bank executives new incentives to seek out riskier strategies and trim reserves to the bare minimum.[4]

Given the powerful competitive pressures banks faced in this period, then, it is no mystery why so many of them ended up getting in over their heads with high-risk, potentially high-reward strategies. The real question—and one that existing scholarship has yet to adequately answer—is why the regulators charged with keeping the financial system safe and stable failed to stop them. In each of the countries where the crisis unfolded, banks operated under the auspices of a well-established regulatory system. But as the experiences of the late 2000s revealed, regulators often fell far short of the goal of protecting the financial system. When we consider that these regulatory failures also arrived on the heels of nearly two decades of development of the international regulatory architecture, the puzzle only deepens. The regulatory failures of this period were also more pronounced in certain countries than in others.

While no country was immune from the effects of the crisis, regulators in some countries (like Canada, France, and Spain) managed to avoid some of the major regulatory missteps that led to serious losses for banks in other countries (like the United States, the United Kingdom, and Germany).[5] Banking regulation may have failed at the global level, in other words, but it also failed more spectacularly in some places than others. In this book, I leverage this cross-national variation to offer new insights into the question of where more or less effective regulatory systems come from.

My central argument is that the systems of financial regulation that defined this era were deeply influenced by the different *principles of order* embedded in national regulatory and political institutions. Or, to state the same point in a different way, regulators in different countries subscribed to different understandings of the causes of prosperity and stability in the economy, which suggested different ideas about how best to regulate finance to promote order. I will show that these divergent principles of order shaped the policy choices of banking regulators at multiple critical junctures, giving rise to regulatory differences with direct implications for how banks in different countries experienced the crisis.

My perspective on regulation (and where it comes from) departs from the conventional wisdom on this subject. When most scholars discuss financial regulation, they tend to treat it as rational—as something that emerges from economic imperatives that *demand* a certain kind of response. Some political scientists and sociologists have challenged this view by underscoring the political roots of regulation. From this perspective, the content of regulation more often reflects the power of certain interest groups (especially the regulated industry) to "capture" regulators, compelling policy makers to introduce policies that serve industry interests. It has been much less common, however, to think about financial regulation as something cultural—as something that emerges from different shared beliefs about efficacy or order among regulators themselves. Recently, scholars have become increasingly open to seeing cultural influences in the development of social policy, like education or social welfare policy, but this perspective has rarely been extended to economic policy making.

This book is an attempt to change that. Even when it came to the fine-grained technical details of banking regulation—one of the most rational of all policy domains—I find that meaning still mattered. In the chapters to come, I show how the broad principles of order embedded in national political and regulatory institutions shaped the way that experts approached their regulatory tasks. As we will see, this approach provides the key to understanding how financial regulation came to be so different across countries, even at a time when regulators around the world had agreed to enforce the same international rules.

Standard Accounts of Regulatory Failure in the 2008 Financial Crisis

Before getting into the details of this argument, it's important to consider how far standard accounts of regulatory success and failure get us toward understanding the regulatory patterns that contributed to the 2008 crisis. Three explanations currently dominate the limited scholarship on this topic. The first explanation emphasizes international influences, with a focus on the weaknesses and limitations of the transnational regulatory framework (the Basel Capital Accord) that governed all internationally active banks after 1988. The second explanation emphasizes the rise of shadow banking, a change within financial markets that made it harder for regulators to understand and effectively govern dynamics in these markets. And the third explanation emphasizes the growing power and influence of the regulated industry, which increased pressures on regulators to relax their standards. These factors are part of this story, but they are not the whole story. Below, I explain why.

REGULATORY FAILURE AT THE INTERNATIONAL LEVEL

In 1988, central bankers from the G-10 countries agreed to enforce the same transnational regulatory agreement, the Basel Capital Accord, which established common minimum standards for bank capital. As highly leveraged institutions, banks operate with very thin financial margins, and unexpected losses can easily drive them into ruin. To protect against this possibility, banks keep resources on hand (capital) to absorb losses before they can impact day-to-day operations. The rise of new requirements for bank capital at the international level was the key shift that redefined the regulatory landscape in the 1990s and 2000s; accordingly, it makes sense that scholars interested in understanding the regulatory failures that featured in the 2008 crisis might start their investigations here.

A sizeable body of research now examines the deficiencies of the Basel Capital Accord. Some of this scholarship focuses on explaining why these international rules failed to restrain risky bank behavior, while other studies go a step further by explaining how these new rules directly encouraged banks to engage in imprudent strategies.[6] Yet attention to these international considerations does not get us very far toward understanding the other part of the puzzle: why regulatory standards in certain countries ended up being so much better than those in other countries in the late 2000s. Even across countries that all complied with the Basel Capital Accord, banking regulation continued to vary considerably, and in ways that mattered for how banks experienced the crisis.

In the chapters that follow, I focus on explaining the divergent development of banking regulation across three countries that were all parties to the

Basel Capital Accord—the United States, Canada, and Spain—yet continued to make different regulatory choices in crucial areas. I chose the United States as the primary case of interest because regulatory choices here carried an outsized impact for the rest of the global financial system.[7] Canada represents a "most similar" case. Although Canadian regulatory standards did depart from American regulatory standards in a few key respects, the regulatory systems of these countries were much more alike than different in global perspective—and these extensive similarities make it easier to identify the factors that led to differences across them. Spain represents a "most different" case. Even by the standards of other European countries, the Spanish bank regulatory system was uniquely strict and interventionist. This case allows us to see whether lessons learned from the close US-Canada comparison continue to apply in a very different context.

The major differences in banking regulation that distinguished these countries can be summarized as follows. In comparative perspective, the US banking regulators did relatively little to prevent banks from gaining exposure to the risks of assets they had *securitized* (e.g., repackaged and sold to financial markets in the form of debt securities). They also failed to encourage banks to set aside significant reserves against these new risks.[8] Additionally, US banking regulators supported excluding banks' financial subsidiaries or affiliates from stricter Basel-style regulation and also endorsed hands-off regulatory treatment for novel innovations like financial derivatives. Each choice carried direct implications for the financial difficulties American banks experienced when the crisis hit.[9]

In Canada, regulatory standards mirrored US regulatory standards in many respects, but they also tended to be stricter in areas that concerned the size or quality of the reserves banks set aside against their risks. Canadian banks faced tighter restrictions on exposures to asset-backed commercial paper programs (a form of securitization), a stronger push to maintain substantial reserves against potential losses from bad loans, and a supervisory framework that encompassed banks *and* their financial affiliates. Each regulatory choice contributed to Canadian banks' ability to weather events that devastated their counterparts in the United States.[10]

In Spain, regulators chose to adopt even more restrictive requirements in many of these same areas. They placed uniquely tight limits on banks' abilities to remove securitized assets from the balance sheet, introduced new regulations that required bankers to increase reserves against bad loans during periods of economic prosperity, and insisted on supervising banks and their financial affiliates as a single, collective unit. While this strict regulatory regime did not prevent the crisis from eventually arriving in Spain, bank outcomes here would have been much worse if Spanish regulators had chosen to copy their US counterparts.[11]

These cross-national differences in banking regulation were not the only things that mattered for bank performance during the crisis, but they did matter. Fully understanding the regulatory failures that gave rise to the crisis, then, requires understanding two patterns at once: why the substantial efforts to strengthen banking regulation at the international level failed to bear fruit *and* why regulators in certain countries used the discretion they enjoyed under these international rules to pursue more or less dangerous regulatory paths. While we already know quite a bit about why the Basel framework failed to keep the global financial system safe, we know almost nothing about why regulatory standards in certain Basel member countries ended up being so much better (or worse) than those in others.

THE RISE OF SHADOW BANKING

One feature that distinguished the 2008 financial crisis from those that preceded it was the heavy involvement of "shadow banks"—financial institutions that, like banks, focus on converting short-term borrowings (i.e., deposits, funds raised in money markets) into long-term assets (e.g., loans, securities), but are not subject to the same regulatory standards as banks. Shadow banks played an active role in the crisis by fueling the origination and securitization of home mortgages, by contributing to the liquidity crunch in funding markets, and by contributing to the lack of market transparency that scared away so many investors in banks and other financial institutions.[12] Some scholars have linked the rising prevalence of shadow banks to the regulatory failures that featured in the crisis by arguing that the transfer of risk from regulated banks to shadow banks prevented regulators from noticing problems until it was too late.

There is no doubt that banking regulators around the world were caught flat-footed by the extent to which credit and liquidity risk built up within the shadow banking system. But this account of regulatory failure, too, struggles to explain the observed regulatory differences across countries. As we will see, there is abundant evidence that regulators around the world were well aware that some risk was shifting outside of the regulated financial system after the 1990s. But they varied in the extent to which they viewed this trend in a positive or negative light. As one example, US banking regulators repeatedly argued that the rise of shadow banking was a positive development that made the financial system safer by enhancing the intensity of market discipline within it. Spanish regulators, by contrast, argued that the same shift presented a serious threat to order in the financial system. These different regulatory views directly informed the different policy choices regulators made in this area. The regulatory failures of this era, then, were not just products of regulatory naïveté in the face of a changing financial market structure. It also mattered how these changes were perceived.

INDUSTRY PRESSURE

A third explanation for the regulatory failures of this period underscores the role of financial industry pressure in encouraging banking regulators to relax their standards. At first glance, this explanation would seem to account for some of the variation we see across countries. The decades after 1980 were defined by rapid growth in the size, profitability, and political power of financial institutions around the world, and these trends were even more pronounced in some countries than in others.

In the United States in particular, financial-sector profits increased sixfold between 1980 and 2009, with commercial banks experiencing particularly large gains. In 1978, the collective assets of US commercial banks totaled around $1.2 trillion, equivalent to 53 percent of GDP; by 2007, they had risen to around $11.8 trillion, equivalent to 84 percent of GDP.[13] The gains of this period were also unevenly shared. In the 1980s and 1990s, the resource share of regional and national banks rapidly increased, while that of smaller, community-oriented banks declined.[14] The total share of industry assets controlled by the five largest US banks increased from around 30 percent in 1997 to just over 44 percent in 2007, while the numbers of banks in operation also declined. In the mid-1980s, there were more than fourteen thousand independent banks in operation in the United States, a number that had dropped below eighty-five hundred by the start of the new millennium.[15]

Many scholars have linked these changes in the structure of the US banking system to the regulatory developments that followed.[16] Starting from the assumption that all regulators are for sale, and that regulation is a commodity purchased by the business groups most interested in and able to buy it, regulatory capture theorists assume that permissive, industry-friendly regulation will become more common as the regulated industry grows more powerful.[17] These scholars argue that regulated firms are especially well positioned to coerce regulators in industries with lower barriers to collective action, as when industries feature fewer individual players to coordinate or where industry resources concentrate in fewer hands.[18] Thus, as the US banking system grew increasingly *consolidated*, *concentrated*, and *resource rich* after the early 1980s, regulatory capture theorists have argued, American banks also became better positioned to secure regulation that aligned with industry interests.[19]

While historical trends in the development of US banking regulation do seem to align with these predictions, placing the US case in comparative perspective tells a different story. In the 1990s and 2000s, the United States did adopt one of the world's most laissez-faire, market-oriented systems of financial regulation. Given this trend, we might have also expected the industry conditions (consolidation, concentration) known to lead to greater power and influence for regulated firms to be especially pronounced in the US context. Instead, we

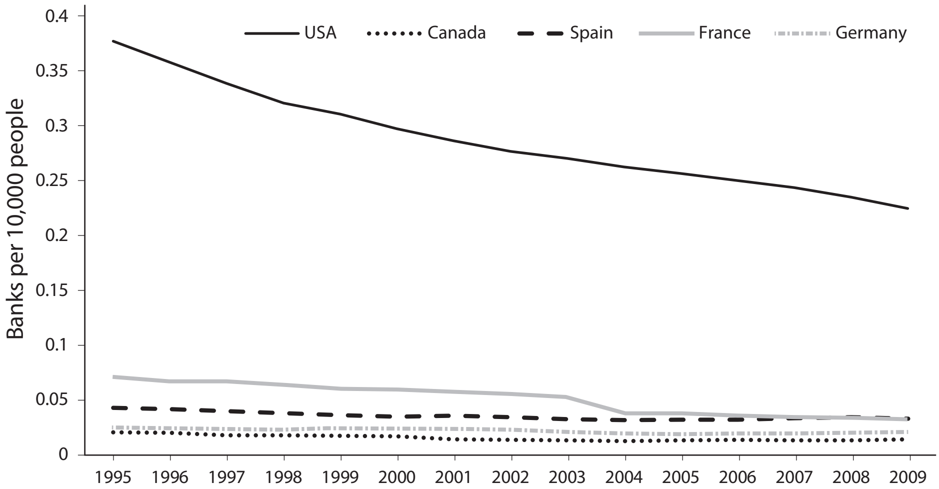

FIGURE 1.1. Banks per capita in the United States, Canada, Spain, France, and Germany. *Sources*: Number of banks: OECD (2014), "Structure of the Financial System," OECD Banking Statistics (database), https://doi.org/10.1787/data-00271-en (accessed September 22, 2014). Population of country: OECD (2015) "Demography and Population," https://stats.oecd.org/Index.aspx?DataSetCode=HISTPOP# (accessed January 12, 2015).

find the opposite pattern. Even as the US banking system grew increasingly consolidated and concentrated over time, it remained far less consolidated and concentrated than the banking system of virtually every other peer country.

To illustrate this point, figure 1.1 compares trends in the number of banks per capita in the United States, Canada, Spain, France, and Germany between 1995 and 2009. As we see, even as the numbers of US banks dropped precipitously over time, the overall level of industry consolidation here remained much lower than in countries with more restrictive regulatory regimes in place. In 2007, there were still about 24 independent banks per million residents of the United States, compared to 3.4 independent banks per million residents of Spain and only 1.3 independent banks per million residents of Canada.

Trends in industry concentration tell a similar story. Using the same five countries, figure 1.2 compares trends in the five-bank asset concentration index, a common measure of industry concentration that reports the proportion of assets that are held by the country's five largest banks as a share of total banking system assets (a higher value on the index suggests a more concentrated industry). Once again, the US banking system did grow substantially more concentrated over time. However, the overall level of banking system concentration in the United States remained much lower than that of virtually every other peer country.

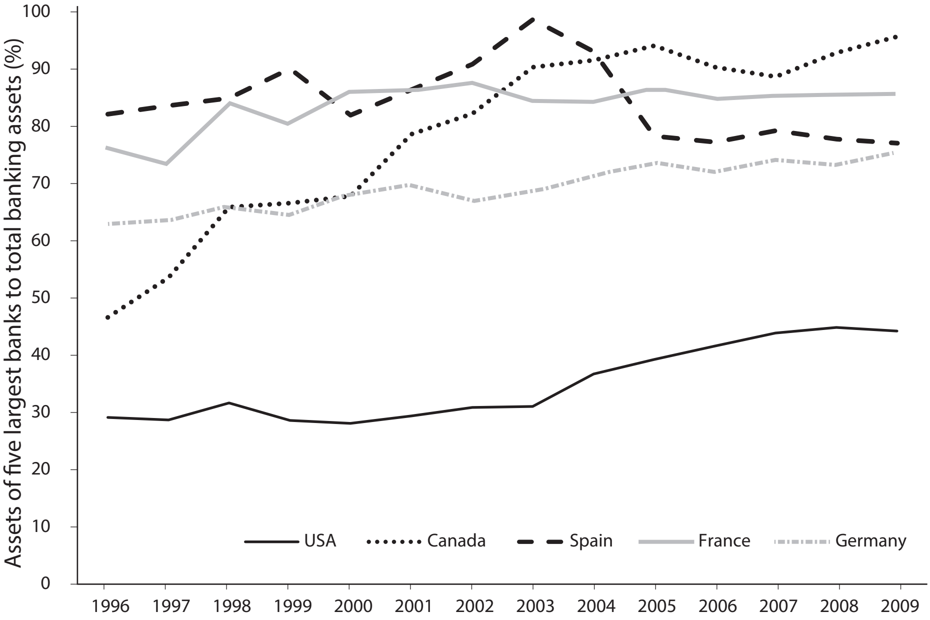

FIGURE 1.2. Top five bank asset concentration index in the United States, Canada, Spain, France, and Germany. *Source*: World Bank, Global Financial Development Database, June 2017 version, https://www.worldbank.org/en/publication/gfdr/gfdr-2016/data/global-financial-development-database (accessed February 1, 2018).

Industry consolidation and concentration are the structural features that have captured the greatest attention from scholars of regulatory capture, because they are thought to be directly linked to the capacity of industry participants to engage in collective action and exert influence over regulators.[20] It is also possible, however, that an industry's capacity for influence could stem from the absolute value of resources its largest members control. In 2005, four of the world's top twenty largest banks were headquartered in the United States, with one of these banks (Citigroup) inhabiting the second-place position. Four French banks and three UK banks were also among the top twenty in this period, as was one Spanish bank and one German bank, but zero Canadian banks.[21] These comparative trends in the mid-2000s, however, are very different from those observed a decade earlier, when only a single US bank held a position among the world's twenty largest banks (Chase Manhattan, at number sixteen) in 1996.[22] While the rising absolute scale of resources controlled by the largest US banks may have very well favored a movement toward more permissive regulation, the timing of this shift implies that this was not its only cause. American policy makers fully embraced a radically more permissive, market-friendly approach to financial regulation in the late 1980s—long before American banks experienced the rapid growth that propelled them into higher positions in the global size ranking. It seems more likely that this turn toward regulatory permissiveness sparked these changes in industry structure, rather than the other way around.

To be very clear: I am *not* arguing that the rising power and influence of the banking industry had zero impact on the development of national regulatory systems, either in the United States or elsewhere. This was almost certainly not the case. In fact, a close look at regulatory policy making in the 1990s and 2000s provides abundant evidence that banking regulators in the United States (and in other countries) were highly attuned to industry interests and kept up a constant dialogue with the firms they regulated. It is also possible that other, less easily measured dimensions of industry power and influence could explain some of these comparative regulatory trends. For instance, the United States could have had a more active "revolving door" between financial institutions and regulatory agencies, which might have given American regulators a greater personal stake in serving industry interests, or, alternatively, paved the way for more subtle "cultural capture" by the regulated industry. For reasons that I will discuss later, I am also skeptical of these explanations. However, in the absence of systematic cross-national data on the career trajectories of banking regulators, it is hard to definitively discount (or confirm) possibilities like these.

These caveats aside, the observation that comparative trends in the structural conditions known to favor regulatory capture did not align with comparative trends in bank-friendly regulation should give us serious pause. At minimum, it implies that scholars of regulation would do well to at least consider alternative explanations for the rise of more or less effective regulatory regimes across countries, instead of assuming that these patterns invariably reduce to trends in industry influence.

Principles of Order Matter

This book offers a fresh perspective on regulation by arguing that different principles of order contributed to divergent approaches to banking regulation in the decades leading up to the 2008 crisis. At first glance, the argument that banking regulators subscribed to different understandings about economic order, which shaped their policy choices, might not seem controversial. Of course, banking regulators (like the rest of us) have their own ways of viewing the world and their place within it, and it is hardly a stretch to imagine that these perspectives might inform the way these actors approached their tasks. Yet serious, sustained attention to the influence of the worldviews and perceptions of banking regulators is surprisingly absent from the scholarship on the crisis, and indeed, from most of the scholarship on regulation itself. In endlessly relitigating whether regulatory policies serve the interests of the general public or those of the regulated industry, scholars of regulation have paid too little attention to the implications of how regulators conceptualize the public interest in the first place.

I suggest that banking regulators from different countries—the United States, Canada, and Spain—made different policy choices in the 1990s and 2000s because they subscribed to fundamentally different understandings about the roots of economic stability and prosperity. In the United States, I find that regulators at the Federal Reserve were heavily influenced by the principle of *competition*, which presented safety and prosperity as deriving from the same source. Competitive market forces, left to their own devices, were expected to automatically select for the most effective strategies, promoting prosperity. Yet these same market forces were also seen as the optimal regulators of undesirable bank behavior, and thus as ideal mechanisms for ensuring financial stability. Automatic and impartial discipline from market actors (like a bank's depositors, shareholders, or creditors) was regarded as the first and best line of defense against excessive risk taking—and American banking regulators sought to preserve this discipline at all costs. As the following quote from a 1997 speech by Federal Reserve Chairman Alan Greenspan suggests, this regulatory commitment to strengthening market discipline was often accompanied by deep skepticism about the benefits of government regulation:

> It is critically important to recognize that no market is ever truly unregulated. The self-interest of market participants generates private market regulation. Thus, the real question is not whether a market should be regulated. Rather, the real question is whether government intervention strengthens or weakens private regulation. If . . . private market regulation is effective, then government regulation is at best unnecessary. At worst, the introduction of government regulation may actually weaken the effectiveness of regulation if government regulation is itself ineffective or undermines incentives for private market regulation.[23]

I will show that this goal of "enhancing market discipline" shaped American regulatory practice by encouraging regulators to mimic market forces as much as possible, to scale back all forms of government intervention into markets (and avoid creating new ones), and to push for the enhanced disclosure of information to market participants. These objectives informed the decisions of US banking regulators in key areas, including the regulation of bank participation in the securitization process and the practice of banks setting aside reserves against potential bad loans.

In Canada, regulators were influenced by the principle of *public rights*, which presented safety and prosperity as deriving from different sources. Here too, regulators assumed that prosperity would emerge most readily in contexts where the state did not interfere with the autonomy of bank managers or directors to freely select desired lines of action. But maintaining economic stability in Canada was thought to require more than market mechanisms alone. Canadian regulators believed that they also had a responsibility to protect the basic rights of vulnerable depositors and other users of banking services by ensuring that banks held adequate safeguards or "cushions" against potential losses. As the following quote from Office of the Superintendent of Financial Institutions (OSFI) Superintendent John Palmer implies, this commitment to striking the right balance between consumer protection and competitive considerations was always at the forefront of regulators' minds:

> The financial sector is key to our current and future economic success. We need a financial sector that offers a competitive array of products and services to Canadians and we need to ensure there is room for competitive, successful Canadian-based financial institutions. . . . While we need to maintain prudential walls around our institutions, those walls can't be higher than those which we see in our major trading partners. . . . OSFI's mandate continues to be the protection of your deposits and insurance policies in federal institutions, but we're trying to do this in a balanced way that recognizes international developments and facilitates a competitive financial system.[24]

This goal of "striking the right balance" shaped Canadian regulatory practice by encouraging regulators to place relatively few limits on banks' abilities to engage in desired activities (including complex financial innovations) while simultaneously insisting that banks hold adequate reserves to counterbalance the risks that they were taking. Regulators also avidly pursued international regulatory harmonization and embraced a "principles-based" regulatory approach with the same goal in mind. These objectives informed Canadian regulatory decision making in crucial areas, including those already discussed above in the US case.

In Spain, regulators were influenced by the principle of *state sovereignty*, which presented centralized administrative oversight and direction as key to both safety and prosperity. Order was thought to emerge most readily in contexts where a single administrator took charge of overseeing, organizing, and directing private initiative in ways designed to promote the greater good. This perspective cast market participants, like bank managers, depositors, or shareholders, as fundamentally shortsighted and incapable of looking beyond their own particularistic interests. State experts, by contrast, had the requisite public-minded motives, centralized viewpoint, and long-term perspective needed to steer private initiative toward an optimal course. As the former official mandate of the Bank of Spain implies, centralized administrative oversight and direction were not just seen as key to maintaining safety and stability—these factors also promoted economic prosperity by facilitating the smooth and harmonious functioning of the financial system:

> The Banco de España supervises credit institutions in a special way. Firstly, a specific regulation has been created to preserve the correct functioning of financial institutions, to strengthen their capacity to deal with adverse events and to harmonise the interests of all parties involved (banks, savers and investors) with general interests, and secondly, they are closely supervised to ensure compliance with banking rules, and in particular, with regulations governing accounting procedures, their solvency, customer protection and market transparency.[25]

This goal of "enhancing state oversight and direction" shaped Spanish regulatory practice by encouraging regulators to focus on keeping bank risk exposures highly visible, to insist on high capital and reserve holdings, and to proactively seek to attenuate disruptive market forces. These objectives, too, directly informed Spanish regulatory decision making in crucial areas.

To understand how principles of order shaped regulatory policy making leading up to the global financial crisis, the metaphor of a card game is useful. Banking regulators in the United States, in Canada, and in Spain were dealt fundamentally different hands in the 1990s and 2000s. By this point, each country had a very different financial system structure, featured different divisions of regulatory authority, and faced different political demands associated with different political systems. These structural features also contributed to the process of divergent regulatory policy making in each country, sometimes in important ways. Yet even amid these structural and political differences, I find that the American, Canadian, and Spanish banking regulators still engaged in discernable "styles of play" that cut across regulatory domains and political contexts. To illustrate this point, the last two chapters of the book take a deep dive into the finer details of regulatory policy making in two domains where regulators faced roughly similar choice opportunities: the regulation of securitization and the regulation of loan loss provisioning. These case studies help to illustrate the process by which these distinctive "styles of play"—or principles of order—gave rise to distinctive regulatory strategies within countries. To fully understand how we ended up with the mess of the 2008 crisis, and to prevent similar events moving forward, I argue that we must devote more serious attention to how banking regulators see the world and what they are hoping to achieve.

Principles of Order and Regulatory Change

Where did these distinctive regulatory worldviews come from? For answers, I look to the political and regulatory institutions that defined each of these countries. An abundant body of scholarship shows how institutions—formal and informal rules, conventions, and arrangements—inform the policy-making process by shaping the kinds of resources, opportunities, and constraints that are available to political actors. Typically, the focus is on the structural or *material* implications of these institutional arrangements: their role in shaping the capacity of governments to legislate or implement policies, the balance of power across various political groups, or even the kinds of players that make it to the bargaining table.[26] But institutions can have cultural effects as well. The same arrangements that shape how power is distributed also come with meanings attached, which can independently affect policy making through their effects on what appears "doable, sayable, or thinkable" to policy makers and other interest groups.[27]

America's notoriously fragmented and administratively weak political institutions, in other words, do not just create roadblocks for advocates of policy change or encourage policy makers to focus on serving narrow geographic constituencies (though they do this too). They also leave the policy makers who inhabit these institutions primed to see benefits in unrestrained competition, dangers in centralized or concentrated power, and harmony in systems that prioritize local control.[28] And these broad principles of order, embedded in the institutions of the polity, also serve as organizational templates or blueprints that actors can apply to the creation of new institutions in other domains of social life. Sociologist Frank Dobbin, for example, explains how nineteenth-century policy makers in the United States, Britain, and France drew from familiar models of organizing political life when designing new economic institutions to organize and govern railroads. Similarly, sociologist Marion Fourcade explains how distinctive political cultures in each of these three countries also facilitated different approaches to organizing the economics profession (and variants of economic knowledge).[29]

My own argument follows in a similar vein by arguing that cultural dimensions of political and economic institutions also shaped the divergent development of banking regulation in the United States, Canada, and Spain in the decades leading up to the 2008 crisis, primarily by making certain principles of order more readily available and salient to regulators in each country. The implication here is that banking regulators are not just members of industry or professional communities. They are also members of national societies, and subject to all the structural and cultural baggage that this institutional membership entails. This argument, however, also features an important twist that distinguishes it from past institutional explanations. Most institutional accounts of regulation—structural and cultural variants alike—focus on explaining how stable institutions facilitate the creation of new regulatory policies that look like a lot like old ones. It is precisely because institutions play such a powerful role in shaping the range of options open to policy makers, in other words, that countries tend to get locked into stable policy patterns that persist for many years. But this style of institutional explanation runs into a problem when it comes to explaining features of the case at hand. When it comes to the recent history of financial regulation, the defining pattern was *not* remarkable stability in the content of national regulatory approaches. It was remarkable change.

To be clear, *recent* regulatory trends—that is, comparative trends in the models of financial regulation that dominated in each country in the 1990s and 2000s—do appear to align with the predictions of a standard institutional account. The United States, for example, is often described as the world's "paradigmatic neoliberal economy," with a long history of eschewing state intervention in the political and economic realms and of creating institutions that celebrate the benefits of market rule.[30] Given this institutional precedent, it is not surprising that US banking regulators would be more receptive to a relatively market-friendly, hands-off regulatory approach. Similarly, Canada is often described as the slightly less market-friendly cousin to the United States, with liberal political and economic institutions that still reflect a preference for the benefits of "peace, order, and good government" over the risk-hungry, revolutionary mentality that prevails to the south.[31] With this precedent, it is not unexpected that Canadian regulators would embrace a slightly more conservative (but still quite market-friendly) regulatory regime. Spain, too, is often described as a country that is more amenable to state participation in both political and economic life, especially when compared to the more liberal regimes of the United States or Canada. Once again, it makes sense that Spanish banking regulators might be more open to a stricter, more interventionist regulatory approach.

But shifting the analytic lens back only a few decades—to the 1960s and 1970s—reveals a very different comparative pattern that challenges the predictions of a standard institutional account. In the 1960s, the United States was not the world leader in laissez-faire banking regulation. Instead, the United States entered that decade with one of the world's *strictest* bank regulatory systems in place, with multiple restrictions on bank structures and activities that other countries did not share. Over the decades that followed, US policy makers were also unusually *slow* to begin dismantling these regulatory restrictions, a pattern that stands in sharp contrast to the common depiction of the United States as the harbinger of neoliberalism. The appendix shows that this pattern applies to nearly every event that is commonly cited as a defining feature of US financial deregulation—from the 1980 deregulation of interest rate ceilings for banks, to the 1982 relaxation of restrictions on thrift activities, to the 1994 repeal of bank branching restrictions, to the 1999 removal of barriers between investment and commercial banking. In each case, these deregulatory events were comparatively *late* to arrive in global perspective.[32] This pattern is important not just because it departs from what institutionalists have come to expect from economic policy makers in the United States. It also departs substantially from the regulatory patterns that would take hold in the same country less than two decades later, suggesting a potential discontinuity in institutional effects.

These unexpected regulatory trends were not limited to the US case. Canadian policy makers may have been lauded for their relatively conservative approach to banking regulation leading up to the 2008 crisis, but banking regulation in Canada took a very different form in the 1960s and 1970s. Canada entered the 1960s with a regulatory system that was exceptionally hands-off and permissive in comparative perspective, defined by comparatively few formal restrictions on bank structures or activities and a well-established tradition of allowing the financial industry to regulate itself. Additionally, Canadian policy makers were relatively quick to repeal the few regulatory restrictions they had in place, dismantling key restrictions (like interest rate ceilings for banks) well over a decade before policy makers in the United States took a similar step.

In Spain as well, the orientation of banking regulation underwent a dramatic reversal between the 1960s and the 1980s. In the early 1960s, Spanish policy makers adopted a highly interventionist regulatory regime that gave the state unprecedented influence in directing credit allocation. Yet by the early 1970s, Spanish regulation seemed to be heading down an entirely different path, as regulators thoroughly embraced the project of financial deregulation. One effect was that by the time that US policy makers finally started to dismantle key regulatory restrictions on banks in the early 1980s, Spanish policy makers were already well down the road toward financial liberalization.

If these unexpected patterns or radical breaks with established institutional traditions had occurred in just one of the countries considered here, we might have been able to explain them away as a fluke or historical anomaly. Yet they happened in all three of them. The discovery of these historical and comparative trends adds important nuance to the puzzle that motivates this book and implies the task of accounting for the emergence of more or less effective bank regulatory systems may be more complicated than it initially seemed. We not only need a theory that can explain why regulatory policies looked so persistently different across countries in the 1990s and 2000s. We also need one that can accommodate the dramatic changes in regulation that occurred *within* these same countries after the 1960s, a process that eventually culminated in the emergence of the regulatory regimes of the immediate precrisis era. This book takes up both issues at once, because, as we will see, our understanding of one will inform our understanding of the other.

Crisis and Conflict among Principles of Order

If institutional legacies within countries are so powerful, then how is radical change possible? This is a question that has intrigued many scholars, who have sketched two major ways that established institutional arrangements can evolve and crumble. Existing policy regimes can collapse rapidly, as when crises upend the status quo and create opportunities for challenger groups to push through new visions, or they can evolve more gradually and endogenously, as when groups with vested stakes in established institutions slowly adapt these institutions to better fit group interests.[33] In the case of financial regulation, crisis seemed to be the primary cause of dramatic shifts in regulatory orientation—including during the puzzling regulatory reversals that occurred in each country between the 1960s and the 1990s. In each country, I find that financial crisis encouraged regulatory change by undercutting the dominance of incumbent groups (those who supported the regulatory status quo), allowing challengers (those who did not) to successfully promote new regulatory models.

While this basic story will be familiar to many scholars of policy change, what will seem less familiar is my account of where these new regulatory models within countries came from. Building on previous scholarship that finds that policy makers often return to discarded past policy experiments and arrangements when searching for new solutions, I show that American, Canadian, and Spanish financial policy makers returned to familiar principles of order when diagnosing and responding to crises.[34] Yet these were not always the principles currently institutionalized in the design of the existing financial regulatory system.

To understand this argument, it is important to first recognize that national institutions like "the state," "the political system," and the "regulatory system" actually comprise *multiple* principles of order. The organization of the American polity, for example, does not just emphasize the merits of using *competitive forces* to organize economic and political life. It also affirms the *sovereignty of the local community* in political and economic affairs and underscores the benefits of combatting dangerous concentrations or centralizations of power.[35] While sociologists have recognized this multifaceted character of institutions, they have also tended to focus on how these multiple principles "hang together" in elective affinities, reinforcing one another to reproduce stable policy patterns over long stretches of time. In the United States, for example, the commitment to a deconcentrated and fragmentated system structure is often depicted as going hand in hand with the commitment to maintaining free competition as the mechanism governing political and economic life. In the words of Theodore Lowi, this American emphasis on "free enterprise" has long "made a happy fit with the native American fear of political power."[36]

But these principles of order are also distinct, which means that they can come into conflict. Consider how attempts to support free enterprise can interfere with attempts to reinforce a deconcentrated system structure when unchecked competitive forces favor the success and growth of larger, resource-rich actors. Similarly, attempts to reinforce community sovereignty can interfere with competitive forces if interventions designed to keep actors small, independent, or locally oriented constrain the full expression of competitive mechanisms.

Closer attention to this *conflict* between principles of order, I argue, provides the key to understanding otherwise puzzling trends in the evolution of national systems of financial regulation—including the dramatic regulatory reversals of the 1980s. Policy makers around the world faced severe and costly financial crises in the 1980s that opened up political opportunities for dramatic reform. Yet policy makers within countries also came to diagnose the causes of these crises in roughly predictable ways. To explain the failures of the regulatory status quo, reform advocates tended to return to principles of order that were *latent* within each country's bank regulatory system—but were still readily available within the broader national institutional context.

Specifically, to explain the troubling financial crises of the 1980s, reformers in the United States drew from the principle of *competition*, which emphasized the benefits of emergent market mechanisms and the dangers of interfering with the process of competitive destruction. They appealed to this principle to explain why a regulatory system previously organized around the principle of *community sovereignty*, which emphasized the benefits of a locally oriented and deconcentrated system structure, had failed to prevent the crisis. This was not the first time that these principles had come into conflict in American debates over financial regulatory reform. The same pattern of conflict also marked debates between Alexander Hamilton and Thomas Jefferson in the early 1800s; the clash between Carter Glass and Henry Steagall over appropriate regulatory responses to the Great Depression in the 1930s; and battles over the desirability of financial deregulation in the 1970s. In the 1980s, this same institutionalized conflict reappeared to guide debates over regulatory reform, with important implications for the kinds of new regulatory arrangements that took hold in the 1990s.

Similarly persistent patterns of conflict also defined historical debates over financial regulation in Canada and Spain. In Canada, conflict over regulation tended to feature tension between the principle of *elite autonomy*, with its emphasis on respect for the freedom of elite individuals to select desired lines of action, and the principle of *public rights*, with its emphasis on the need to protect the basic rights of individuals from exploitation by powerful others. This distinctive pattern of conflict was present in the very first debates Canadians held over the creation and regulation of banks; as in the United States, it also reappeared to shape many other debates, including those in the aftermath of the financial crises of the 1980s. In Spain, conflict over regulation centered around tension between the principle of *corporatist harmony*, with its emphasis on respecting established social hierarchy and proactively brokering harmonious relationships between social groups, and the principle of *state sovereignty*, with its emphasis on giving a centralized administrator the ultimate authority to organize and direct activity within political and economic systems. This conflict also shaped key debates over financial regulation throughout Spanish history, including the influential debates that followed in the wake of the crises of the 1980s.

Importantly, the final outcomes of these national conflicts over financial regulation were never predetermined. The political dynamics or economic conditions of the historical moment often shaped the specific ways such conflicts were resolved. Indeed, this indeterminacy within institutions is key to understanding how radically different regulatory regimes could develop within countries across different historical periods—including in the two periods that are most relevant for the present investigation, the 1960s–1970s and the 1990s–2000s. Yet even as we acknowledge the influence of power, politics, and historical contingency in regulatory policy development, it is equally important not to lose sight of the institutional principles of order that were operating in the background. Looking across historical periods in comparative perspective, it becomes clear just how often a narrow range of principles of order shaped the arenas in which key national reform battles took place. My point is that the story of the regulatory failures that gave rise to the global financial crisis can't be told without them.

The Organization of the Book

This book is divided into three parts, each focusing on a specific historical juncture in the development of national bank regulatory systems. The first part opens in the 1780s, when the first modern chartered banks emerged in the United States, Canada, and Spain. To support the central argument of this book, that principles of order shaped the evolution of banking regulation, it is important to show that the relevant principles preceded the first conflicts over bank regulatory policy. Chapter 2 describes the distinctive principles of order, institutionalized in political institutions, that characterized the American, Canadian, and Spanish political systems in the late eighteenth and early nineteenth centuries. A key point is that political institutions represented order in different, sometimes conflicting, ways within countries. Chapter 3 illustrates how the underlying principles of order embedded in these political institutions also informed the way that Americans, Canadians, and Spaniards debated and developed bank regulatory policies between 1780 and 1860. Chapter 4 extends this story into the twentieth century by showing how the same principles of order also informed crucial debates and developments in national bank regulatory systems between 1860 and 1920.

The second part of the book explains how these institutional traditions contributed to the puzzling evolution of the American, Canadian, and Spanish bank regulatory systems over the course of the twentieth century. It focuses on three successive crisis episodes, each of which played an important role in the development of bank regulatory policy in each country. Chapter 5 compares national regulatory responses to the disruptive financial crises of the 1920s and 1930s. It shows how conflict between the same principles of order that featured in the earliest bank chartering and regulatory debates continued to inform the debates that followed these crises. In the United States, advocates of *community sovereignty* faced off against champions of *competition*; in Canada, advocates of *elite autonomy* challenged arguments founded on the principle of *public rights*; in Spain, advocates of *corporatist harmony* battled advocates of *state sovereignty*. In each case, the way that these debates were ultimately resolved carried implications for the relative dominance of a particular principle of order within the financial regulatory regime. The policy choices of this period contributed to the emergence of a bank regulatory system organized around the principle of *community sovereignty* in the United States; the principle of *elite autonomy* in Canada; and the principle of *corporatist harmony* in Spain.

Chapter 6 examines the implications of this process, explaining how these dominant principles of order, institutionalized in the design of the bank regulatory system, shaped national approaches to the problems of rising inflation in the 1960s and 1970s. In each case, policy makers initially responded to these problems by experimenting with financial regulatory reforms that aligned with the principle already embodied in the existing regulatory system. However, by the 1970s, these prevailing regulatory models were already starting to show cracks, as advocates of alternative regulatory approaches emerged to challenge supporters of the regulatory status quo in each country. Attention to this process offers unique insight into some of the most puzzling regulatory trends of this era, when comparative regulatory patterns across countries seemed to depart from common expectations.

Chapter 7 accounts for the dramatic reversals in regulatory orientation that occurred in each country during the turbulent 1980s. Faced with disruptive financial crises that raised serious questions about the sufficiency of existing models of banking regulation, reformers in each country seized the political moment to successfully push through new approaches. Yet even these new models continued to align with long-standing institutional traditions, reflecting the influence of the latent principles that had *lost* in each country during the reform battles of the 1920s and 1930s. Attention to this process of crisis and institutionally influenced reform sheds new light on the roots of the American regulatory compulsion with enhancing market discipline, the Canadian regulatory commitment to proactively protecting vulnerable consumer rights, and the Spanish regulatory obsession with promoting centralized oversight and guidance.

The third part of the book explains how these events contributed to the development of distinctive goals among banking regulators in the United

States, Canada, and Spain in the 1990s and 2000s and details some of the practical effects of these different regulatory perspectives. Chapter 8 describes the broad visions of financial order that guided regulatory policy making at the Federal Reserve (in the United States), OSFI (in Canada), and the Bank of Spain (in Spain) in the two decades leading up to the 2008 crisis. It underscores the connections between these regulatory perspectives and the diagnoses of the crises of the 1980s that were institutionalized in the dramatic legislative reforms described in chapter 7. Cross-national differences in regulatory goals are not reducible to economic or political dynamics, or even to differences in the professional training or backgrounds of regulators. Instead, I argue that widely shared national interpretations of the most recent episode of financial disorder—interpretations shaped by previously latent principles of order—directly informed the kinds of goals and strategies American, Canadian, and Spanish banking regulators pursued in the 1990s and 2000s.

Chapters 9 and 10 illustrate the practical effects of these distinctive goals and strategies. Chapter 9 takes a deep dive into the development of the regulation that governed bank exposure to asset-backed commercial paper (ABCP) programs. The 2007 collapse of the ABCP market is generally understood as a major precipitating event of the 2008 financial crisis and a source of losses for commercial banks around the world. This chapter explains how different priorities among regulators in the United States, Canada, and Spain informed the divergent development of regulation in this crucial area, which was nominally governed by international regulatory standards.[37] The US regulators, focused on enhancing the influence of market discipline in banking, actively encouraged banks to participate in securitization markets (and removed potential impediments to this participation), with disastrous results. Canadian regulators, focused on the need to strike the right balance between prosperity and stability, took a more measured approach, doing very little to prevent banks from pursuing innovative activities, yet taking a hardline stance on the reserves banks held against the risks of these activities. Spanish regulators, focused on enhancing regulatory capacity to oversee and direct activity in the banking system, placed strict limits on bank participation in off-balance-sheet securitization, which they perceived as threatening to regulatory order.

Chapter 10 further illustrates the influence of these different regulatory worldviews by showing how they also shaped the development of regulations governing the loan loss provisioning practices of banks, a domain of regulation under exclusive national control, with important implications for bank performance during the crisis. Collectively, these chapters illustrate how distinctive regulatory goals and worldviews contributed to the divergent development of regulatory policies across countries.

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