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THE POLITICS OF FINANCIAL REGULATORY REFORM

[Abstract] Financial regulators are key actors in a modern political economy given their role in determining the rules that govern savings and investments markets. This is an account of how two states, Britain and Germany, have sought to increase their oversight of financial markets by creating powerful new regulatory actors that are accountable to the political system. In both cases, this meant either ending or severely limiting the role of central banks and private actors as regulators. The aim is to show why domestic politics is key to understanding this major institutional change. Using a coalitional approach, this paper argues that politicians view the increased salience of financial regulation as a policy issue. The political response was triggered in large part by major changes in the composition of savings markets and the consequent “privatization of risk”, where voters are increasingly dependent upon financial markets in order to determine their future financial security. It argues that, for center-left parties, creating the new regulators allowed the parties to portray themselves as protecting the interests of voters while also appealing to more traditionally left suspicions about the power of both central banks and markets.

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THE POLITICS OF FINANCIAL REGULATORY REFORM

Jonathan Westrup

I. INTRODUCTION

Britain and Germany, two of the European Union's largest economies, have made radical changes to their financial regulatory institutions over the past decade. Both states have created a new single financial regulator, replacing the functional separation of responsibility between banking, securities and insurance regulators. However, this study argues that the change is more fundamental than just a functional redesign and perceives two defining characteristics of the new regulatory regimes of both states, albeit to a more limited degree in the case of Germany. First, a corporatist regime characterized by a high level of self-regulation has been replaced by one controlled by a single, powerful, state actor that is clearly accountable to government and parliament. Second, the role of the respective central banks in financial regulation has been diminished: within Britain, the Bank of England has been completely removed from its role as a regulatory actor, while, in the case of Germany, the Bundesbank has been rebuffed in its attempts to expand its regulatory role. Both characteristics can be indicated as a desire by state and, in particular, political actors to increase their oversight of financial markets.

Given the significant role of financial regulation in determining the rules of the game as they apply to the conduct of savings and investment markets, an increased oversight role for state actors is important. These rules are important in shaping policy outcomes that have significant distributional consequences; hence, private and state actors can be assumed to have distinct preferences about the design and structure of regulatory institutions, particularly in regards to the balance between self-regulation and the role of the state. An explicit decision by political actors to limit the role of private actors in financial regulation, and to increase state oversight in an attempt to ensure the accountability of markets to

political institutions, can be seen as an important change in the relationship between the state and markets.

Arguments used to explain previous changes in regulatory regimes such as American regulatory hegemony, Europeanization, the pursuit of economic efficiency, and the role of ideas and epistemic communities cannot adequately explain this shift from a corporatist- to a state-regulatory regime.¹ Instead, this paper argues that the new regime is best explained by the changed incentives to political actors—arising from the increased salience of financial regulation as a political issue—and their subsequent desire to create a regulatory institutional actor that is clearly accountable to the political system. The determining factor in the growing salience of financial regulation is the shift in financial risk to the household sector, described here as the privatization of risk (IMF 2005). This shift has two important components: first, in terms of pensions, the increasing exposure of individuals to investment risk due to the reluctance of both the state and firms to provide guaranteed returns and, second, the growth in risk assets as household investments are shifted from bank deposits to stock holdings. For politicians, the pursuit of regulatory policies designed to protect the interests of voters who are exposed to financial risk becomes electorally attractive, creating an incentive for them to challenge the regulatory status quo of the corporatist/self-regulatory model.

The paper argues that political actors, as recognized by Polyani in a previous era, have incentives to insulate individuals from economic risk and, in this situation, to create regulatory

¹ The paper does find that economic efficiency and ideas do play a significant role in explaining the change in regime with economic efficiency important in both the British and German cases, while the ideational example of the FSA was significant in spurring the German debate. However, as discussed later in the paper, they are not sufficient as independent variables to explain the change in regulatory regime.

institutions accountable to the political system (Polanyi 1944). However, the paper recognizes that political actors are not the only state actors interested in regulatory change, but are also joined by government actors represented by the Treasury (or Finance ministry), and private actors, who promote an efficient system of financial regulation in order to ensure the competitiveness of the domestic financial sector.

The paper uses a “coalitions theory”—initially espoused by Gourevitch, and later by Frieden, Rogowski, and others—to explain institutional change by tracing the evolving preferences of the relevant state and private actors and the changing coalitions that they form (Gourevitch 1986, Rogowski 1990, Frieden 1991). However, there are two important differences from both the ambition and scope of previous coalition constructs. First, the emphasis here is on explaining change in formal statutory institutions. Second, there is an explicit examination of the preferences of elected politicians as a specific state actor. The separation of elected politicians’ preferences from those of other state actors is warranted because the changes in savings markets triggered by the privatization of risk has made electoral incentive relevant, where previously there was little incentive for political actors to become involved in a policy area that could be described as classic “low politics”.

This paper examines the preferences of three distinct state actors: elected politicians, the officials at the Treasury/Finance ministry, and central bankers. In terms of private sector actors, the paper traces the preferences of the trade groups that formally represent banks, investment banks, pension funds and insurance companies. The shift to the new state regime is explained by a new coalition between elected politicians and Treasury/Finance officials that led to the subsequent exclusion of the central banks that had been deeply involved in the design of the previous corporatist regimes.

Financial regulatory regimes are politically contested, with institutional “winners and losers”, and central bankers are the losers (Zysman 1983). The evolution of the new regulatory regime

provides support for Thelen's argument that political institutions depend upon political support for their continued existence (Thelen 2004). In this case, the privatization of risk changed the incentives for political actors, ending the cohesion of the state actors involved in designing the previously corporatist regimes.

The separation of state actors allows for an explicit exploration of the role that partisan politics has played in the creation of the new regulatory regimes and makes room for a hypothesis as to why it was center-left parties that decided upon the change. Center-left parties had a clear electoral strategy of reaching out to voters affected by the changes in savings markets by offering policies that protected the consumer interest in financial markets. They also appealed to the traditional left in asserting the state's role in relation to financial markets. Such an argument has important similarities with that of Cioffi and Höpner in their study of corporate governance reforms where again they found that center-left governments were critical to reform (Cioffi, Höpner 2004).

The paper primarily uses an endogenous explanation of regulatory change, rather than the exogenous explanations contained in much of the literature on financial regulation. Moran, for example, argues that the "agenda of regulatory change in Britain was an agenda set by American events and American influences" was key in explaining the shift from "club regulation" to "mesocorporatism" in 1986, when British state and private actors had little choice but to acquiesce to "Americanization" if London was to remain a competitive financial center (Moran 1991: 132).² Scholars such as Luetz, Coleman, Vogel and Laurence also look to exogenous explanations of financial regulatory change (Luetz 1998,

² Moran's argument does not dismiss the significance of domestic politics in enabling state actors to overcome the resistance of domestic financial actors that were resistant to change, "a pluralist, competitive political system allowed disaffected interests to mobilize for change", but he does not place emphasis on it as a variable as compared to Americanization (Moran 1991: 57).

Coleman 1996, Vogel 1996, Lawrence 2001). The exogenous hypotheses are of obvious importance in explaining why corporatist regulatory regimes were created, but they cannot adequately explain the shift to the state regimes observed in the two cases. We must look at partisan politics and the changing incentives of political actors in order to understand the change in regimes.

A. CASE SELECTION

The selection of Britain and Germany can be justified under a “most different” approach to their political and economic institutions (Przeworski and Teune, 1970). Britain is, in Lijphart’s classic typology, a majoritarian state with relatively few veto points (Lijphart 1999). In terms of its economic system, it is a state where equity-based financing of firms has played a decisive role (Zysman 1983). Germany, by contrast, is characterized as a consensual state, with its federal political structure ensuring many political veto points (Lijphart 1999). In terms of its economic system, it is traditionally characterized as a bank-based financial system with a significant level of state-ownership (Zysman 1983). In terms of political economy, the two states are generally considered to be the classic examples of the two ideal types, with Britain as a liberal market economy, and Germany as a coordinated market economy (Hall and Soskice 2001).

The paper proceeds as follows: first, it describes the evolution of the previous regulatory regimes in the two states; second, it examines why existing hypotheses struggle to explain the perceived shift from corporatist to state regimes; third, it describes the privatization of risk and the pension reforms in both states before explaining the implications for financial regulation; fourth, it argues why the privatization of risk has offered center-left parties an electoral opportunity to appeal to voters that are also financial consumers; fifth, it describes the changing preferences of the state and private actors in both states; finally, it draws implications from a comparison of the cases before considering some conclusions.

II. THE EVOLUTION OF THE CORPORATIST REGIMES:

A. BRITAIN

The evolution of the financial regulatory systems reflects the different institutional endowments of the two states' contrasting political and economic systems. As Moran describes, British financial regulation, with the exception of insurance, was originally a club-based system (Moran 1991). Britain had little, if any, statutory regulation; instead, its system was organized into self-regulatory groups, with no statutory role for the Bank of England as the regulator of the banking system until the 1979 Banking Act (Reid 1982, Moran 1986). Securities regulation was effectively determined by the self-regulatory code of the Stock Exchange until the passing of the 1986 Financial Services Act, which established what Moran terms a *meso-corporatist* regulatory regime, with the statutorily empowered Securities and Investment Board (SIB) overseeing a range of Self-Regulatory Organizations (SROs) that were created from previously existing self-regulatory groups.

To explain why club regulation was ultimately replaced, Moran, Vogel and Laurence all point to exogenous explanations of change that rely on variants of "Americanization". The central actors promoting change were those of the state and not the market, as the Department of Trade and Industry (the Treasury took responsibility for securities regulation in 1991), and the Bank of England ended their support for Stock Exchange self-regulation to ensure the continued competitiveness of the City of London. While the 1986 legislation was a decisive step away from self-regulation, it was also clearly corporatist because significant regulatory powers were left in the hands of the self-regulatory bodies or practitioner bodies.

None of the accounts point to private market actors as having played a decisive role in the transformation. It is clear that, at least initially, domestic institutions in the securities markets were

primarily interested in protecting their franchises from foreign competition and opposed any change in the regulatory status quo.

[A] THE UNRAVELLING OF CORPORATISM

The new regulatory regime was controversial almost immediately. Two major pension scandals came to light, both of which were deeply embarrassing to the government and the SIB/SRO regime. The financial collapse of the Maxwell media empire, following the death of Robert Maxwell in 1991, brought to light evidence that the pension assets of the Mirror group were being used to provide financial collateral for other parts of the family business and that the relevant SROs had not detected the fraud, nor had they sufficient powers to prevent it. However, it was evidence of pension mis-selling that caused even greater political embarrassment for the Conservative government. The Thatcher government had introduced private pensions in 1986 that used fiscal incentives to encourage some 7 million people to opt out of both SERPS (State Earnings Retirement Pension Scheme) and occupational schemes to take up a personal pension in their place (Institute of Fiscal Studies 2000). However, evidence quickly came to light that many people were persuaded to opt out of schemes against their best interests, thereby provoking a major pensions mis-selling scandal. Again, the regulatory regime had neither flagged the problem nor had the SROs proved to be effective in punishing the relevant institutions or identifying senior figures within the miscreant firms.

Regulatory failures were not only found in the pensions and the securities industries. Two major banking failures in the first half of the nineties brought the supervisory role of the Bank of England under major review. The BCCI failure in 1991 was a high profile supervisory embarrassment, bringing into doubt the Bank's ability to oversee institutions with major overseas operations. However, that paled next to the collapse in February 1995 of Barings, one of the most venerated names in the City of London, following the failure to observe a derivatives trader's massive losses (Gapper and Denton 1996). Barings' failure prompted both an independent

inquiry and a House of Commons Select Committee inquiry into the Bank's supervisory role, both of which were very critical.

[B] CREATION OF THE FSA

The New Labour government, some two weeks after winning the General Election in May 1997, announced the creation of a single regulatory authority. While the new regulator initially retained the name of the previous statutory regulator, the SIB, it had markedly different powers. First, the the SROs were disbanded and their functions were merged into the statutory body. Second, the supervisory functions of the Bank of England for the entire banking system were transferred to the new entity. Some few months later, the organization was renamed the Financial Services Authority (FSA). The creation of the FSA was a clear shift in the relationship between the British state and financial markets. All vestiges of the self-regulatory regime were swept away, and the traditional conduit between the City and the government was stripped of its oversight function, creating a new regulatory paradigm (Hall 1993).

B. GERMANY

The German financial regulatory regime was quite different from that of Britain for two reasons. First, it reflected the limited role of capital markets in the German economy and a bank-based financial system. Second, the tradition of corporatism was more deeply embedded, reflecting the consensual nature of the political system.

The role of the state in banking regulation has a relatively long history, dating back to the banking failures of the thirties but, in the modern context, it was formalized with the creation of the Bundesaufsichtamt für das Kreditwesen (BaKred) in 1961 (Muller 2002). However, given the limited role of formal regulation at this time, the legislation did not formally differentiate the role

between the BaKred and the newly created Bundesbank, but an informal agreement was arrived at where the BaKred determined regulatory policy and the Bundesbank, using its federal structure, carried out the actual mechanics of site supervision.³

A defining comparative element of the German regulatory system was the lack of a federal securities regulator prior to the creation of the Bundesaufsichtamt für den Wertpapierhandel (BaWe) in 1994. Lütz describes how the “Frankfurt coalition”, made up of both state and private financial actors, had lobbied for securities reform since the late eighties as the private banks, in particular, were concerned that their competitive position was undermined by the lack of formal regulation, damaging Finanzplatz Deutschland and risking access to global capital markets (Lütz 1998). The key members of the Frankfurt coalition, as described by Lütz, were the Bundesbank, the Finance ministry and the private bankers’ trade association, the Bundesverband Deutscher Banken (BdB). As with Britain’s securities reform, the key state actors—the Finance ministry and the Bundesbank—were in agreement on the need for securities regulation. Karl Otto Pohl, President of the Bundesbank, made a strong statement in 1989, committing the central bank to reform. The key difference from Britain was the importance of private sector actors in advocating for new regulatory institutions.

The period between the creation of BaWe in 1994 and the decision to merge the regulators in 2001 was not marked by the high-level financial failures as in Britain. However as is discussed later, there was an important shift in German savings markets as the shift out of cash deposits into risk assets gathered momentum following the

³ As Muller (2002) points out, significant regulatory tasks such as deposit insurance and auditing were delegated by the BaKred to “semi-private” organizations, confirming that banking regulation had a significant corporatist component.

privatization of Deutsche Telekom and the dramatic rise in equity markets in the late nineties.

[A] CREATION OF BAFIN

In Germany, the SPD/Green government announced the creation of a single financial regulator, BaFin in January 2001. This new institution merged the three existing regulators, BaKred the banking regulator, BaWe the securities regulator, and BaV, the insurance regulator. The announcement followed what Schuler describes as “a heated public debate” that went on for almost two years reflecting the federal, consensual nature of the polity before Hans Eichel, the Finance minister announced his decision (Schuler 2004: 12). The minister used similar terminology to that of Gordon Brown as he claimed that the new regulator would be both more efficient for Finanzplatz Deutschland and that it would serve the interests of financial consumers.

III. ALTERNATIVE HYPOTHESES

At this stage of the paper, it is appropriate to assess why existing hypotheses used to explain regulatory change struggle to explain the shift from corporatist to state regimes in the two cases.

A. AMERICANIZATION/EUROPEANIZATION HYPOTHESIS

The term “Americanization” refers to regulatory reform as an “American creation and a response to American circumstances”, to use Moran’s definition (Moran, 2002: 266). Other scholars use the term regulatory hegemony, which, as a broad concept, is perhaps the most widely used exogenous hypothesis. The causal mechanisms that explain change in this argument are, therefore, the increasing global importance of American financial firms, particularly in Europe, which has forced European governments to adopt U.S. style regulatory regimes, if they wish their financial centers to be attractive to U.S. firms, and if they wish to allow their firms to participate in the American market. However, a quick comparison of the very diffuse US regulatory system, which

has key roles for the Federal Reserve as overseer of the banking system, the SEC for the securities markets, state regulation of insurance companies, and a range of other regulatory agencies for other financial institutions, means that is little evidence of a regulatory impulse from Americanization (Government Accountability Office 2004).⁴ Indeed, corporatism is still a defining feature of US financial regulation, as the continued, if controversial, self-regulatory roles of institutions such as the New York Stock Exchange prove. The removal of the Glass Steagal restrictions on different types of banking activities has allowed for a greater degree of financial conglomeration, but there is little evidence that financial firms are advocating regulatory consolidation. In terms of state actors, the Federal Reserve chair Alan Greenspan, has specifically ruled out the case for consolidation (GAO 2004).

Europeanization—seen in this context as “top-down”, and understood as the mechanisms by which EU policies and directives affect the domestic policies and institutions of member states—has also played no role in the shift from corporate to state regimes (Radielli 2003, Borzel 2005). Given the diverse designs of national regulatory structures, with major states in the European Union (*e.g.* France, Italy and Spain) maintaining functional separation, the Lamfalussy proposals, the Financial Services Action Plan and the European Parliament have all shied away from proposing unanimity in regulatory design. However, in an interesting parallel with the German and British cases, the EU governments decided not to give the ECB a role in overseeing the supervision of banking despite very active lobbying for such a role (Padoa-Schioppa 2004). Instead they decided to create functional EU level regulators, with a banking regulator in London, a securities regulator in Paris, and an insurance regulator in

⁴ The Gramm-Riley reforms of 1999, which removed the barrier on banks and investment banks carrying out certain functions, meant that any functional argument against combining regulatory reforms is no longer valid.

Frankfurt, retaining the right to merge them at a future date. (Davies 2004).

B. ECONOMIC EFFICIENCY HYPOTHESIS

Financial institutions and the products they sold became increasingly similar during the nineties. A rising number of financial conglomerates, the bancassurance model, and a situation where banks, insurance companies and securities houses increasingly sold each others' products, began to make the case for a division of regulators on functional grounds appear increasingly anachronistic (Lumpkin 2002). Financial firms were attracted by the prospect of reduced transaction costs as a result of interacting with fewer regulators. For Treasury/Finance actors, there was the appeal of a more efficient regulatory structure, which would improve the competitiveness of domestic financial centers while also allowing for a better appraisal of financial firms' total risk, reducing the risk of regulatory failure (Davies 2004, Padoa Schioppa 2004).

However, for central banks, such changes created two specific problems. First, such changes took them away from their areas of banking expertise, and exposed them to consumer regulatory issues in which they traditionally had little experience. Second, the issue of moral hazard was raised by the question of what financial institutions were to be covered by the central bank's traditional lender of last resort function (Goodhart 2002). These problems coincided with an important change in the relationship between governments and central banks, as the Bundesbank paradigm of monetary policy independence became increasingly the norm following the Maastricht Treaty, leaving the accountability of the central banks' in the area of prudential responsibility as an open question. This awkward dilemma proved to have important consequences for the regulatory role of central banks.

A financial efficiency hypothesis appears therefore to offer some strong arguments. For state actors, there was a clear incentive to

improve risk assessment of financial institutions. For private financial actors, there was the attraction of lower transaction costs. Is it possible to argue that the pursuit of increased economic efficiencies could alone explain regulatory reform? There are three important arguments as to why such an argument is not sufficient to explain the regulatory change we have observed.

First, it would be a fair assumption that states with the most integrated financial institutions would have the greatest incentive to merge their regulators. However, as Table 2 points out, this

Table 2: Bank and Insurance Market Share of Financial Conglomerates

	% Banking	% Insurance	Total
Britain	57	12	69
Germany	10	75	85
France	67	30	97
Italy	37	21	58

Prast and van Lelyweld (2004)

does not appear to be the case as neither Britain and Germany have comparably different levels of integration compared to France and Italy which have chosen not to integrate their regulatory structures. Second, the fact that the United States, the state with the largest financial services sector economy in the world has chosen not to merge its regulatory structures appears to indicate that other hypotheses are required. This assumption is supported when it is considered that France, Italy and Spain have also chosen not to merge their regulators. Third, particularly in the British case, Treasury/Finance actors were not able to persuade right-of-center political actors to agree to regulatory reform. Economic efficiency arguments therefore require that government actors be persuaded of their political advantage.

However, where economic efficiency does play a role in explaining change is in the added impetus the creation of the FSA gave to German state and private actors interested in promoting regulatory change, supporting the argument that, without a single

regulator, Finanzplatz Deutschland was again placed at a competitive disadvantage.

[A] IDEAS/EPISTEMIC COMMUNITIES HYPOTHESIS

The role of ideas and epistemic communities in explaining change in economic institutions has become increasingly popular over the past few years (Haas 1992, Hall 1993, McNamara 1998, Schmidt 2002, King 2005). McNamara has laid out a useful three-stage ideational model that explains how ideas and the epistemic communities that promulgate them can be significant in explaining change based on policy failure, paradigm innovation, and policy emulation (McNamara 1998). In the case of Britain, there was a clear case of policy failure in the corporatist regulatory regime. However, for the state and private sector actors interested in promoting change during the mid-nineties, there was no obvious regulatory paradigm to turn to when considering reform of their regulatory structures. The only OECD states that had chosen to consolidate their regulatory structures into a single regulator were the three Scandinavian countries, Norway in 1986, Denmark in 1988 and Sweden in 1991 and, as Taylor and Fleming describe, they were different from virtually all other OECD states in so far as their respective central banks had never had responsibility for banking supervision (Taylor and Fleming 1999). Also, as described earlier, the US—the regulatory regime that had provided the paradigm for the previous iteration of regulatory change—did not change its functional separation of regulatory responsibilities.

In regards to the epistemic communities, neither of the two key academic reports suggested a single regulator, but rather a “Twin Peaks” model where the prudential and the business activities of regulation were to be housed in separate regulatory institutions (Taylor 1995, Goodhart 1996).⁵ However, there is no evidence that

⁵ The Twin Peaks solution was the model decided upon by the Australian government in 1997 (Wallis Commission 1997).

British Treasury actors considered the adoption of the Twin Peaks model when evaluating new regulatory architectures. Britain decided, therefore, in McNamara's terms, to create a new regulatory paradigm.

For Germany, McNamara's model offers some interesting applications. While the previous regulatory regime did not fail in a dramatic sense, the creation of the FSA and the apparent success of its new paradigm did offer German actors interested in promoting a new regime a template that could be used as an example when promoting regulatory change. Policy emulation was therefore potentially significant in explaining the creation of BaFin. However, as with the economic efficiency argument, there is considerable doubt as to whether, had a CDU/FDP government had been elected in 1998, BaFin would have been created even with the existence of the FSA model.

IV. PRIVATIZATION OF RISK

At this stage, it is important to expand upon the term "privatization of risk", and to tease out why the term is important to explain the changed political incentives of political actors and, in particular, center-left parties. As the IMF has pointed out, there has been a marked shift in the bearing of financial risk from the state, firm, and financial institutions to the household sector over the past decade (IMF 2005). The result, in regards to pensions, is that households have had to take on "more responsibility for ensuring sufficient contributions to their defined plans, for generating adequate investment return from those plans and for coping with the longevity risk" They also point to the "growing use of mutual funds and direct holdings of stocks and bonds by

retail investors have exposed the household sector to market fluctuations" (IMF 2005: 4).

There are important differences between Britain and Germany in the degree to which the privatization of risk has occurred, with change happening earlier and more radically in Britain. As discussed earlier, the Thatcher government had provided fiscal incentives to encourage the opting-out of the state SERPs pension scheme. However, there were also changes in private schemes as an increasing number of firms in the nineties shifted their pension systems from defined benefit to defined contribution schemes (Pension Commission 2004: 85). Again, this shift meant that, instead of the firm guaranteeing an employee a pension of a certain percentage of salary, the decision for both the level of pension savings and the type of investment risk was transferred to the individual. For the government and firms, the incentive was reduced costs but, for the individual, the defined contribution pension meant exposure to the volatility of financial markets and the resulting impact on the size of their pension savings.

The major changes to the German pension system were not enacted until 2001 with the introduction of what became known as the Riester reforms (Busemeyer 2005). The fundamental nature of these reforms was the introduction, for the first time, of a defined contribution occupational scheme where employees receive fiscal incentives to participate and where the funds have to be invested in the financial markets. These funded schemes leave the decision to the individual worker to decide where to invest their contributions. While the uptake of the new scheme was initially disappointing, and further changes followed in 2003, the reforms marked a major long-term shift away from state pension provision to one dependent upon financial market returns.

However, the introduction of funded pensions was only one, if significant, element of the privatization of financial risk. Both governments have offered tax incentives over a prolonged period to encourage long-term savings that, while structured differently, had a similar effect of encouraging individuals to switch their savings

out of bank deposits into risk assets such as stocks and mutual funds managed by financial institutions. The encouragement of citizens to buy shares in privatized state companies was a further aspect of the state's encouragement of the purchase of risk assets. In the German case, a significant element of the structuring of the financial risk continues to be borne by financial institutions due to the tradition of a guaranteed return on investment products.

Table 1. Composition of household assets (in % of gross financial assets)

		1980	1990	2000
Britain	<u>Deposits</u>	43	31	22
	<u>Risk Assets</u>	53	61	74
	Bonds	7	1	1
	Equities	12	12	17
	Institutions	30	48	56
Germany	<u>Deposits</u>	59	48	34
	<u>Risk Assets</u>	33	44	60
	Bonds	12	16	10
	Equities	4	7	16
	Institutions	17	21	34

Source: Davis 2003

A. PRIVATIZATION OF RISK AND REGULATORY REFORM

What does this transfer of risk from governments and firms to individuals mean for the politics of financial regulation? There are two related paths that can be identified as important in influencing the incentives of political actors. First, the increased exposure of voters to the vicissitudes of the financial markets gives politicians a clear incentive to ensure that the interests of these financial "consumers" are represented in the governance of those markets. Second, there is an increased incentive for political actors to ensure that savings institutions, such as banks,

mutual funds and insurance companies, where voters place their savings, are well run and remain financially solvent.

However, as the privatization of risk increased and with it the number of voters exposed to financial markets, it was the incentive to create a regulatory institution with a strong consumer mandate that became a new phenomenon. An institution with such a mandate can be seen to play a proactive role in creating suitable safeguards for financial consumers while also allowing for a level of blame avoidance when regulatory failures do occur. Such an objective, however, can come into conflict with other political incentives to promote certain macroeconomic goals, notably the smooth functioning of financial markets, the role that financial institutions play in providing credit, and the means by which savings are invested in the economy. A regulatory regime must, therefore, balance the interests of financial consumers with those of private financial actors who are quick to point out the onerous nature of regulation in terms of cost and the effect on a financial center's competitive position.

B. CENTER-LEFT PARTIES AND CONSUMER PROTECTION

It is not a coincidence that center-left parties in both our cases have initiated regulatory change. It can safely be assumed that political parties seek policies that increase their chances of election (Downs 1957). In this regard, Kitschelt points to the incentives for parties "to map new issues onto an existing unidimensional space of competition" so as "to take advantage of opportunities offered by the dynamic of competitive party democracy" (Kitschelt 2001: 265). There are two reasons why protecting the interests of financial consumers (an issue resulting from the privatization of risk) is attractive to center-left parties such as New Labour and the SPD/Green coalition. First, it was an issue clearly consistent with the consumer orientation of left and green parties and their traditional suspicion of financial institutions and the role of financial markets. Second, it offers the opportunity to appeal to all those voters that had become exposed to financial markets through the changes in the long-term savings

markets. Such a policy has even more electoral attraction at a time when center-left parties have struggled to find issues that lay out explicit differences across the ideological spectrum (Garrett and Lange 1991). However, the electoral advantage of creating a single new regulatory agency was also attractive because it could be couched in efficiency terms, appealing to a wider business audience that “new” left parties interested in a third way or *Mitte Weg* did not want to alienate. The paper now turns to an examination of the preferences of the specific state and private actors in light of the privatization of risk.

C. STATE ACTORS: BRITAIN

[A] TREASURY

For senior Treasury officials, the readily apparent failings of both the SIB/SRO regime and those of the Bank of England prompted serious concerns. The Treasury, which as a government department had only assumed responsibility for the regulatory framework from the Department of Trade and Industry in 1992, made the continued competitiveness of the City of London its first priority, because of the city’s major contribution to the national economy. The Treasury’s concern was heightened because of a perception that much of the City’s activities were not naturally rooted in the economy and that regulatory duplication and failure could undermine its competitive position (Interview: London 11/8/04). The Treasury’s reaction to regulatory failure and the increased political salience of financial regulation due to the privatization of risk was therefore a conscious attempt to improve its efficiency. By 1996, the management board of the Treasury had agreed in principle that the regulatory structure should be consolidated into a single regulator, but did not consider that there was a possibility that the Bank of England would agree to give up its supervisory role within the banking sector. However, the Conservative Chancellor, Ken Clarke, when presented with the proposal, showed no interest in it (Interviews: London 11/8/04 and 11/9/04). The option of handing over regulation to the Bank of England as a means of consolidating all regulation was not

seriously considered as it was felt that would have entailed “too many conflicts of interest”, due primarily to fears of contamination of the Bank’s monetary responsibilities (Interview: London 11/8/04). Such a transfer of powers would also have entailed a serious loss of responsibility for the Treasury and, given the clear, if low-key, rivalry between the two institutions, it was never realistically considered. For the Treasury as an institution, economic competitiveness and efficiency arguments were clearly persuasive. However, due to the lack of interest from the Conservative chancellor, they had no means of implementing their desire for change.

[B] BANK OF ENGLAND

Having played a pivotal role in the decision to remove “club government” from the City in 1982, and in designing the SIB/SRO structure that was decided upon in 1986, the Bank was the clear regulatory “loser” among the regulatory actors during the nineties as its supervisory role came under serious scrutiny and was ultimately removed.

The Bank defended itself vigorously following BCCI and Barings by arguing that failure was inevitable under any regulatory regime and that the Barings failure had not meant any loss of government moneys (George 1995). It did not officially discuss any formal change in its supervisory role, but in internal discussions considered creating an agency such as the Commission Bancaire in France that, while formally controlled by the Banque de France, was a separate agency that undertook supervisory responsibilities (Interview: London 5/18 2004).

However, if the failure of BCCI and Barings had put the supervisory role under a major cloud, the Bank began to assume a more public role in terms of its monetary policy role following the Conservative government’s decision to publish the minutes of the meetings between the Chancellor and the Governor of the Bank in 1994 (King 2005). New Labour’s decision to grant operational independence to the Bank for conduct of monetary policy days

after the May 1997 election victory was greeted with great elation by both the financial markets and the bank. However, the Chancellor's statement at the time announced that it was "the government's intention to consider transferring part of the Bank of England's responsibility for banking supervision to another statutory body" (Brown 1997a). The Bank took this to mean that such a proposal was to be discussed, so there was major surprise when, on the 20th May, the Chancellor informed the Governor that all supervisory responsibilities were to be removed and a new single financial regulator was to be established (Brown 1997b).⁶ The news was described by two former senior Bank of England officials as "a bolt from the blue" and that it "came as a thunderclap," and it was widely reported that the Governor consider resigning (Interviews: London: 5/17/04, 5/18/04).

The Bank of England, in contrast to the Bundesbank, did not publicly comment after the FSA decision, issued no formal statement, and did not lobby against the decision.

There was a realization that, given the political realities, there was no choice but to accept the loss of regulation and consequent prestige. It is easy to point to the failures of both BCCI and Barings as the key factors in New Labour's decision to remove supervision from the Bank. However, it is clear from a comparative perspective that banking failures do not always mean that governments choose to strip central banks of their oversight role. The example of Credit Lyonnais in France, which was bailed out in spectacular fashion in 1995 and ultimately cost the French government some 24 billion dollars, led to no change in the supervisory role of the Commission Bancaire and its overseer, the Banque de France (Coleman 2001).

⁶ The Bank of England was however given the formal responsibility for ensuring the overall stability of the banking system.

D. PRIVATE ACTORS: BRITAIN

There is little formal evidence that private financial actors or their representative groups lobbied for a single financial regulator. None of the four key trade groups that represent the City firms, the London Investment Banking Association (LIBA), the British Bankers Association (BBA), the Investment Managers Association (IMA), nor the Association of British Insurers (ABI) sought such a change, either formally or informally. There was undoubted dissatisfaction expressed by both LIBA and the IMA to the Treasury about the cost of regulatory duplication caused by the SRO structure. However, it is clear all four groups were surprised at New Labour's decision to create a single regulator and, in particular, to remove the Bank's powers of supervision (interviews).

There were four important reasons for this surprising acquiescence. First, New Labour had just been elected with a very large majority and could claim a decisive electoral mandate to implement its manifesto, making it politically awkward for financial firms to oppose the new government's policies. Second, the institutional ownership of the City's securities markets was unrecognizable compared to a decade earlier. Virtually all the major stockbroking firms and investment banks had sold their businesses to American or continental firms, leading to the term *Wimbledonisation* where, as with the tennis tournament, no British player won—but the tournament was always a success (Augar 2001). The consequence of this was evidence of a significant disruption in the long established networks between the City and state actors during the nineties as compared to a decade previously. Third, the consolidation and conglomeration among financial firms that had taken place over the previous decade created a collective action problem in terms of firms and their industry groups, undermining the possibility of presenting a cohesive position (Interview: May 2004). For example, investment bankers had different regulatory priorities from fund managers. Fourth, the creation of a strong regulator with the power to oversee markets, may well have been in the institutions' interests

in terms of assuaging investors' worries about the credibility of their savings following the high-profile regulatory failures. Financial firms had been, not surprisingly, a major supporter of the Conservative government's policies that promoted the privatization of risk. The pension reforms of 1988, privatization and the promotion of shareholder capitalism, and tax induced long-term savings plans were all policies that were of major benefit to City firms. It is clear therefore that, when evidence of the pension mis-selling and other regulatory failures came to light during the nineties, it was difficult for financial firms to actively oppose a major regulatory reform.

In terms of private actors, there is evidence of continuity in Moran's observation of the lack of active participation in the shaping of regulatory institutions (Moran 1991). It would be a mistake, however, to interpret this lack of formal involvement to mean a lack of political influence. It is clear that the Treasury, in particular, was acutely aware of the importance of the financial sector to the broader economy. However, the fact remains that New Labour decided to create a single regulator without any prior formal consultation with private sector actors and presented the City with a *fait accompli*.

E. THE POLITICAL PARTIES: BRITAIN

[A] NEW LABOUR

It was the manifest failings of the SIB/SRO regime, and its inability to prevent regulatory failures, particularly the pensions mis-selling scandal and the Barings failure, that provided the immediate political opportunity for New Labour to attack the regulatory regime created by the Conservative party and to ensure that financial regulation emerged as a distinct area of policy difference between the parties. Gordon Brown, in his role as Shadow Chancellor, used these failures to relentlessly attack both the SIB/SRO regime and the Bank of England. Prior to the 1997 General Election, the Labour party committed itself in its Business Manifesto, to reform the regulatory regime when, without giving

any details, it promised to create what was termed a “Super-SIB”, that brought together the SROs and gave the regulator increased powers (Labour 1997).

It was the decision to give the Bank of England operational independence over monetary policy that provided the opportunity to redesign the regulatory framework and create a single regulator by removing the Bank’s supervisory responsibilities and transferring them to the new regulator (Interview: London 11/9/2004, Bower 2004). When the Chancellor announced the decision some two weeks after the monetary policy statement, he couched it in distinct terms using both consumer protection and economic efficiency arguments, stating that the new regulator would “raise the standard of supervision and investment protection that industry and the public have a right to expect” (Brown 1997).

In terms of political incentives, such a move was designed to play to both a new constituency as well as appeal to what may be termed traditional Labour party interests. First, the consistent emphasis on protecting the interests of the consumer and increasing the accountability of regulation gave New Labour the opportunity to identify new policy issues. Second, shift in emphasis was designed to allay the concerns that traditional Labour politicians might have regarding the decision to give the Bank of England monetary policy independence, as well as any concerns they might have over the relationship between the state and the City.

[B] CONSERVATIVES

For the Conservative party, having introduced the SIB/SRO regime in 1986, financial regulation became an issue of considerable subsequent political embarrassment, as the party was forced to continually justify a failing regime. However, there is no evidence that it ever contemplated changing the corporatist system during its period in office. First, given its ideological position on the pre-eminent role of markets, it was never convinced of the need for

state oversight of the financial markets in the first place (Brittan: 1986). To increase the role of the state in regulation was never considered as a viable political option (Interview: London 11/9/04). Second, even when the cumulative effect of the deficiencies in the regulatory regime became clear during the mid-nineties, the Conservatives party realized it was going to lose the next election, so it had little incentive to initiate reforms to the system.

That said, if the Conservatives had remained in office, it is extremely unlikely that they would have created a single regulator like the FSA and removed supervisory responsibility from the Bank of England. Described by one former Tory Treasury minister as “a socialist measure,” the party was, not surprisingly, immediately critical of the powers given to the FSA (Interview:11/9/04). Typical of the criticism was a pamphlet, co-written by a Conservative MP that described the FSA as “a too powerful Leviathan, overbearing and unaccountable” (McElwee and Tyrie 2000). As a counterfactual, it is likely that the Conservatives would have consolidated the SRO structure and possibly strengthened the powers of the SIB, but there is no evidence that they would have removed responsibility for banking regulation from the Bank of England. Therefore, the politics of New Labour can be seen as decisive in the creation of the FSA.

F. STATE ACTORS: GERMANY

[A] FINANCE MINISTRY

The concerns that led the Finance ministry to propose the creation of BaFin had evolved from the concerns about the competitiveness of Germany as a financial center that were central to the decision to set up BaWe six years earlier. While competitiveness remained of crucial interest, particularly after the British government's decision to create the FSA, there was a deeper concern about the condition of the overall financial system (Interviews Berlin: 5/15/04, 11/15/04). Of particular concern were the low levels of return on capital within the financial system during the nineties compared to other major EU and OECD states, which increased

the vulnerability of individual institutions to economic shocks. As the IMF remarked “the German system appears to be less strong than those of other countries reviewed, owing to lower profitability or weaker capitalization’ (IMF 2003). The proposal to increase the funded component of pensions, outlined in the Riester reforms, was a further incentive to ensure that the regulatory regime could ensure the robustness of the financial institutions that would manage the savings products. The Finance ministry was also concerned about the effect of further reforms emanating from the EU challenge to the status of the Landesbanks and the ongoing Basel 11 negotiations, both of which had the potential to further reduce the profitability of the banking system.

The Finance ministry’s concerns about the German financial system were not new but the previous CDU/FDP had expressed little interest in reform. For the Finance ministry, the increased privatization of risk was therefore an important concern from the perspective of the capability of the financial system to avoid significant financial failures.

[B] BUNDESBANK

It is an apparent paradox why the Bundesbank failed in its efforts to expand its supervisory role given its status as a key parapublic institution of the federal Republic due to its identification with postwar economic success (Katzenstein 1987:60). It is clear that, at the end of the eighties, the Bundesbank was an important member of the Frankfurt coalition that lobbied for regulatory reform in the interests of promoting Finanzplatz Deutschland (Lütz 1998). However, there is little evidence that the Bundesbank’s interest in regulation and financial supervision was particularly profound until the imminent arrival of European Monetary Union towards the end of the nineties. Up until then, it is clear that supervision was seen very much as the poor relation when compared to its

vaunted monetary policy role⁷ and that risk of “regulatory contagion” was to be avoided at all costs.⁸

The effective arrival of EMU in 1999 and the transfer of responsibility for monetary policy to the European Central Bank appear to have triggered a realization that regulation was an obvious way to augment its now diminished responsibilities. The Bundesbank began a very public campaign to lobby for an expanded regulatory role.

Both the President, Ernest Welteke and the Vorstand member responsible for regulation, Edgar Meister, argued that given the Bundesbank’s “closeness to the market,” the BaKred should “be taken under its roof” (Meister 1999). Welteke quickly followed up with a more ambitious plan in an interview some months later, when he remarked that there were “many good reasons why the BaWe and BaV should also come under the roof of the Bundesbank” (Welteke, 2000).

It was a major surprise, then, when Finance minister Eichel announced in January 2001 that the government had decided to set up BaFin, leaving it unclear as to whether the Bundesbank would have any regulatory role. The Bundesbank immediately issued a strong statement of disapproval and Meister was quoted that, “banking oversight is not suitable for the business of politics” (FAZ 1/26/01). While the Bundesbank gained support from the Lander government of Hesse and Bayern in its opposition to the

⁷ A former senior Bank of England official described how Bundesbank officials would take pleasure in describing the risks to the credibility of UK monetary policy arising from its financial supervisory role (interview: London: 5/14/04).

⁸ An account that confirms this impression was the reported reaction of Bundesbank President Helmut Schlesinger during the aftermath of the Barings failure in early 1995, when questioning his officials about the Bundesbank’s potential exposure to such an event, he made it clear that the BaKred’s responsibility for regulation should be stressed (interview: Berlin: 11/15/04).

government's proposals, it had managed to alienate many of the other Lander governments with its proposal to reduce the number of Lander members of its Vorstand (Busch 2004b). The Federal government did give some ground when it agreed to leave the Bundesbank's supervisory responsibilities unchanged; the legislation finally clarified the relationship between the Bundesbank and BaFin by outlining an implementational role for the Bundesbank. However, the failed attempt to expand the Bundesbank's regulatory remit was evidence of its diminished role as a parapublic institution in German politics.

G. PRIVATE ACTORS: GERMANY

Lütz describes the key role that private sector actors—notably the BdB, as the lobby group for the private banks, and Deutsche Bank, as the largest private bank—played in the Frankfurt coalition that led to the creation of BaWe in 1994 (Lütz 1998). The incentive was to ensure the competitiveness of German financial institutions in an evolving global financial marketplace. This motivation was little changed in the debate about regulatory reform, where both the BdB and Deutsche Bank again played a key role, both in terms of influencing the public debate and lobbying the government as supporters of a new, single regulator. For Deutsche Bank, the fragmented regulatory structure was considered an impediment to its strategic development (Interview: Frankfurt: 11/16/04). A measure of its concern was the bank chair's Rolf Breuer's unusually forceful speech in February 2000 when he argued that there must be an integrated regulator and that “the supervisory authority must be subject to a reporting requirement and democratic control” (Breuer 2000). This can clearly be interpreted as an attempt to head off the Bundesbank's ambitions to expand its regulatory remit, and is evidence of the robustness of the debate when the central bank and the state's largest bank are willing to enter into a very public disagreement. The BdB also publicly challenged the Bundesbank's attempts to increase its oversight role and, echoing Breuer's earlier comments, described the dual oversight role as outmoded. The BdB argued that banking

regulation needed political control, which made the Bundesbank unsuitable as a regulator (*Süddeutsche Zeitung* 5/30/00).

What was also notable about the debate was the public split between the different financial interest groups, disturbing the usual corporatist consensus, as the BdB assumed the role of champion for the move to a single regulator, while the DSGV argued in favour of the Bundesbank.⁹ The savings and cooperative banks were concerned that any change in the regulatory regime might disturb their well-developed network of political support at both a Federal and Lander level.

H. POLITICAL PARTIES: GERMANY

In the case of the German political parties, it is clear that there was a high level of political consensus on the need for reform of financial regulation up until the decision to create BaFin in 2001. In the three previous Financial Market Promotion Acts of 1990, 1994 and 1997, all the parties voted in favor of the legislation and the SPD's main criticism (as the opposition party) was that the legislation was continuously late in implementation (Bundestag proceedings)¹⁰. However, as the effect of the first three pieces of

⁹ One leading financial commentator described it "as amazing that in Germany it is only the private banking sector that is calling for a legally independent authority in financial supervision. The savings bank sector has been on the sidelines and the cooperative banks openly calling for supervision under the Bundesbank" (Engelen 2000).

¹⁰ The SPD member Martin Bury was critical in the 1997 debate about the legislation due to the "big defects in terms of transparency and the protection of investors" but still described it as "a long-overdue step in the right direction, even if it is still too little" (Bundestag proceedings 1997).

legislation was only to bring Germany belatedly into line with the regulatory norms of the other large EU states, and did not involve any contentious decisions about institutional responsibilities, such unanimity was not surprising.

However, the unanimity soon dissipated when the debate about institutional reform began. The issue that was immediately contentious was again the role of the Bundesbank and its ambitions to expand its regulatory remit. What emerged was a clear split between the SPD/Green government, which was strongly in favor of the new single regulator, and the CDU and FDP, which were equally vehement in their views that the Bundesbank should have its supervisory role expanded.

[A] SPD/GREEN

The incentives to promote reform, from a partisan perspective, were broadly similar to those of New Labour in Britain. The nature of the German savings markets had changed rapidly in the latter half of the nineties due to the major privatization of Deutsche Telekom and an equity boom that saw a rapid rise in the individual holdings of stocks (DAI 2003). The creation of a regulatory actor that actively promoted the protection of the consumers of financial services can be seen as a strategic response to such a change. However, unlike New Labor, there is little evidence that the SPD/Green government had considered regulatory reform prior to coming to power and the protection of consumers was not a contentious issue during the 1998 election, as Germany's financial system had not undergone the same high-profile failures that Britain's financial system had experienced (Interviews:11/14/04).

A key difference was that the SPD/Green government was introducing private pension reforms where New Labour had reacted to the failures of the previous Conservative government's policy. This meant that the SPD/Greens had to be seen creating a new regulatory regime that could protect the interests of *prospective* savers as opposed to the New Labour case of creating a

regime to protect *existing* savers. It also meant that the SPD/Greens had to prevent regulatory failure to avoid damaging the case for transferring pension risk from the state to the individual and the institutions where they committed their pension savings.

For the SPD there were three objectives in promoting BaFin: first, a desire to increase the protection of investors; second, a clear concern about lack of democratic accountability of the Bundesbank as a regulator; and third, a concern that financial regulation should function effectively and efficiently. The proposed Riester pension reforms were clearly an additional and important impetus (Interview:11/10/04). However, unlike New Labour, the SPD were in coalition and for their partners, the Greens, consumer protection was a key element of their electoral strategy. An example of this commitment was their promotion of the Ministry of the Rights of the Consumer that, among other policy areas, was established to oversee financial claims (Interview: Berlin 11/15/04). Both members of the coalition could agree on the creation of a financial regulator with a strong consumer orientation, while dismissing the claims of the Bundesbank to take control of regulating an increasingly politically important policy area.

[B] CDU/FDP

Neither the CDU nor its previous coalition partner, the FDP, which were in government between 1982 and 1997, had shown an interest in reforming financial regulation when in power. In part, given the bank-based financial system, there was little electoral incentive for the parties to promote reform as a political issue. This can be seen as a result of both parties' traditionally close relationship with the Bundesbank. While all German political parties pay homage to the Bundesbank, both the CDU and the FDP

were particularly supportive of it as an institution.¹¹ As one CDU official stated “We are very pro-Bundesbank, historically and today” (Interview, Berlin 11/15/04). Given the Bundesbank’s lack of interest in financial regulatory reform until the end of the nineties, neither of the two parties when in government wished to initiate a policy that ran counter to the Bundesbank’s goals.

When the debate began over the future of the regulatory regime, both parties strongly supported the case for an expanded role for the Bundesbank, and opposed the idea of creating a new regulatory institution. When the government announced the BaFin decision, both parties continued to argue in committee and in the plenum sessions of the Bundestag that the case for change was not proven. However, despite the opposition party’s majority in the Bundesrat, they failed to prevent the legislation being passed into law because of an extraordinary walkout by the CDU leaders in a dispute over immigration policy (FT Deutschland 2002). This meant that the legislation was not sent into the conciliation process that might have delayed the establishment of BaFin for a considerable period.

V. COMPARISON OF CASES

The evidence from the cases points to significant findings about the trajectory of institutional change. First, there were important changes in the interests of two key state actors that prevented the unanimity among them that led to earlier corporatist reforms. The Finance/Treasury actors were active proponents of regulatory change. They were concerned about the need to promote the competitiveness and efficiency of their respective financial systems. The center/left governments were advocates of regulatory change because of the electoral advantage they perceived in

¹¹ Both the SDP and the Greens in the parliamentary debate about BaFin were careful not to criticize the Bundesbank in an overt fashion. As a Green official commented, “it is impossible in German politics to criticize the Bundesbank” (Interview: 15/11/2004).

promoting a broad consumer agenda due to the privatization of risk and changes to savings markets (in the German case, the prospective nature of pension reform meant that concern for the effectiveness of the regulatory system was also an important to the SPD/Green government). The regulatory losers in both cases were therefore the respective central banks, which as Thelen's argument suggests, can be explained as the result of having lost political support for their regulatory roles (Thelen 2004). For both center/left governments, there was a reluctance to allow institutions that were perceived to be insufficiently accountable to the state to assume regulatory powers in a policy area of such political salience. It should be stressed that for both governments, the argument in favor of merging the functional regulators was about more than improving economic efficiency; it was also about ensuring the political accountability of the new regimes.

In both cases, there are two reasons that make the partisan argument so compelling. First, the right parties previously in power showed little interest in reforming the corporate regimes. Second, when in opposition, both the Conservatives and the CDU/FDP actively opposed the creation of the new institutions and the increased role of the state. Their opposition, in particular, to the reduction in the role of the central banks points to a strong counterfactual argument that, without New Labour's electoral success of 1997 and the SPD/Green of 1998, neither the FSA nor BaFin would have been created.

The cases also show two important differences in the evolution of the regulatory regimes. The first is the difference in the role of private financial actors where, in contrast to Germany, British private actors are found not to have played an important role as either advocates of reform, or as opponents once reform was announced. This is an interesting finding in so far as it appears to challenge assertions of the "structural power" of financial firms found in the literature (Cerny 1993, Strange 1995). In the German case, a significant finding is the division the debate caused between the different banking associations, disturbing the usual consensual style of policymaking.

The second difference concerns the debate that took place in both states, and it reflects the contrast between the two political systems. As we have seen, New Labour announced the decision to create a new regime without any formal consultation process. In Germany, by contrast, the debate stretched over an extended period, with state institutions and private sector actors taking very public positions and was only finally resolved by legislation.

VI. CONCLUSION

This paper argues that partisan politics matters when explaining change in the institutions of financial regulation. It points to the changing interests of two key sets of state actors, Treasury/Finance and elected politicians, that can explain the shift from a corporatist to a state financial regulatory regime in Britain and Germany. For Treasury/Finance actors, there was a concern to increase regulatory efficiency, both to reduce the risk of regulatory failure and to promote the competitiveness of each state's respective financial centers. For elected actors, the changing nature of savings markets following the privatization of risk, offered the two center-left governments an opportunity to pursue an electorally attractive pro-consumer policy. The regulatory losers, in both cases, were the respective central banks, because of their perceived lack of political accountability.

However, the cases indicate that neither the economic efficiency arguments of Treasury/Finance actors, nor the ideational example of the FSA in the German case, are sufficient in themselves to explain the changes in regulatory regime. While both economic efficiency and ideas play a significant role, the decisions of center/left governments were necessary for the change in regime to occur.

The implications for the paper are obviously limited by the examination of just two cases, even if they do represent very different political and economic systems. However, it is interesting to note that the three large European states, France, Spain and Italy that have chosen to leave significant regulatory

powers with their central banks, and have also chosen not to reform their pension systems in such a way as to encourage private funded schemes.

This paper has clear normative implications in so far that, when center-left parties relinquish power in Britain and Germany, given the opposition of the right parties to the removal of the regulatory roles of central banks, there may well be fundamental changes to the institutional design of the financial regulators and a consequent lessening of focus upon the interests of financial consumers.

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