Socio-Economic Review (2010) **8**, 537–557
Advance Access publication June 14, 2010 doi:10.1093/ser/mwq009

DISCUSSION FORUM I

Crisis in the regulation regime—a new paradigm?

At the 21st SASE conference in Paris, in July 2009, a session was organized around the question of whether the financial and economic crisis would lead to the emergence of a new paradigm in the regulation regime. The following are the revised contributions of the four participants: Bruno Amable, Robert Boyer, David Levy-Faur with co-author Christine Parker, and Steven Vogel.

Keywords: regulation, markets, capitalism, crisis
JEL classification: G01 financial crises, G18 government policy and regulation, L5 regulation and industrial policy, P1 capitalist systems

Bruno Amable

University of Paris I Panthéon – Sorbonne and CEPREMAP, France

Correspondance: Bruno.amable@ens.fr

The pre-crisis *doxa* was based on the idea that the development of modern economies was suffering from excessive regulation and that the institutions inherited from the so-called Golden Age of the post-war years were not suited to new forms of capitalism, particularly the emergence of the 'knowledge-based society' (e.g. Sapir, 2004). The policy prescription was to implement a series of structural reforms that aimed roughly at deregulating the economy so as to increase the competitive pressure on agents. All areas of the economy were concerned: product markets were privatized and competition-regulating legislation was dismantled; the employment relationship was altered by increasing the flexibility of the labour market and reducing employment protection; and, of course, the financial system changed with the rise of market finance against intermediated finance and with capital owners given a central role over stakeholders, and financial 'innovations' generalized in a way that proposed new ways to manage risk and offered new possibilities for financial investment. The deregulation paradigm was therefore proposed as a coherent package (Braga de Macedo and Oliveira Martins, 2006).

The recent financial and economic crisis has questioned the belief in the superiority of deregulation as a dominant paradigm for modern economies. When the world financial system was on the brink of collapse, many commentators proclaimed that this was the end of neoliberal 'self-regulated' capitalism/the Anglo-Saxon model. French president Sarkozy, who had been elected shortly before on a programme of neoliberal reforms, wanted to introduce subprime mortgages in France and took pride in the nickname '*Sarkozy l'américain*' because of his admiration for the Anglo-Saxon model of capitalism, was led to declare the end of self-regulated markets and the victory of the European model over its American counterpart. Even *The Economist* (May 7, 2009), which had once held that France needed a Margaret Thatcher to turn its model into a fully fledged neoliberal economy, claimed the existence of a new pecking order in Europe: *le modèle français* on top and the Anglo-Saxon model at the bottom.

Indeed, the financial and economic crisis is an interesting test of the 'power of ideas'. As an ideology, the doctrine of deregulation and market self-regulation was brutally devalued with the crisis; one should expect, on the basis of the force of rational arguments alone, a significant turnaround in the ideological mood and a break with the priority given to neoliberal reforms. However, if one is more sceptical about the power of ideas and more confident in the power of (economic, social, military etc.) power, one is inclined to be less convinced about the reality of the 'return of Keynesianism' or the 'return of the state'. The neoliberal reforms that were implemented more or less comprehensively in developed and developing countries over the last three decades were not so much the result of the scientific superiority of neoliberal ideas but rather the outcome of a social and political struggle between social groups. The social forces that were powerful enough to impose neoliberalization are not very likely to make amends following the near-collapse of the world financial system. To get an idea of the resistance to change, one needs simply look at what was said at a roundtable between French top managers and CEOs in January 2009: 'Do we need a better regulation [of the financial sector]? Probably. But *fortunately* this has nothing to do with a pseudo refoundation of capitalism' (S. Weinberg, Chairman of the Board of Accor); 'When I hear about the refoundation of capitalism, *I reach for my gun*' (M. Cicurel, CEO of the Compagnie financière E. de Rothschild, *emphasis added*). The general tone of the roundtable was summed up by the title given to the newspaper article reporting it (Journal des Finances, January 10, 2009): 'Top Managers Fear the Exit from the Crisis More than the Crisis Itself'. Indeed, when one's personal income is measured in millions of euros, the risk of a refoundation of capitalism is more worrying than that of unemployment.

Considering the seriousness of the financial crisis, surprisingly little has been done by way of regulating the international financial system. Most of the decisions taken at the various G20 meetings are based on rather mild regulatory measures (capital requirements, supervision by Central Banks etc.) and rely more on the self-regulation paradigm than on state control of financial activities. Again, considering the economic weight of the rescue plans, it would have been considered 'normal' by many (not only the general public, but also academics) to nationalize the banking system so as to avoid a particularly bad case of 'public losses, private benefits'. In the USA, the Obama administration has hesitated to take drastic measures such as the reintroduction of the Glass-Steagal Act and preferred the tax instrument to initiate a separation between commercial and investment banking; and one had to wait until 2010 to see the administration adopt a moderately threatening stance against the banking industry. In Europe, much fuss has been made about bonuses and the lack of decency of bank managers in order to hide the fact that little was done to alter the fundamental features of the financial system.

The feeling of 'business as usual' that one could get is even more pronounced when attention is directed towards other institutional areas. The question of a course reversal is not even mentioned, as far as labour or product markets are concerned. The official religion of the European Union is still 'free and fair competition' that is supposed to be achieved through deregulation. The push for structural reforms is, therefore, not likely to weaken, as can be assumed from the statement of the General Secretary of the OECD: 'It is important to emphasise that the debacle in financial markets does not call into question the beneficial effects of recommended reforms of product and labour markets' (OECD, 2009).

Considering the importance of complementarities between institutions, one may gather that the reforms of the financial system are limited, out of necessity. The idea that the neoliberal agenda could be pursued in all areas but finance and that competition and deregulation would apply to all economic agents but banks and financial investors are a pure fiction. As was emphasized before the crisis, 'a liberal reform package has to be comprehensive by nature' (Braga de Macedo and Oliveira Martins, 2006, p. 4). One can hardly imagine a situation in which a simple financial patch would be applied to the whole neoliberal programme, which would remain otherwise untouched. Labour-market and product-market deregulations will lead to an increase in demand for financial services and hence the development of financial innovations. The same could be said about the privatization of education or the fiscal policy reforms favouring high incomes that have been implemented in most developed countries over the past couple of decades.

There is no ready-made 'solution' to the existing contradictions. The financial sector has its own dynamics; supported by powerful social groups, as the examples of the USA and the UK show. More fundamentally, the crisis is not simply limited to the financial sector; it affects the whole neoliberal model, in particular, the contradiction between the neoliberal reforms that increase pressure on wage-earners, especially those at the lower end of the income scale, and the necessity to keep up a certain pace of consumption growth for macroeconomic reasons and political stability. This contradiction was partly resolved thanks to the generalization of a growth model based on credit growth instead of real-income growth for the vast majority of households in the USA and other countries that had followed the neoliberal model. Resolving the contradiction on a long-term basis implies a reversal of the trend in income distributions in most countries, a trend that has meant an increase in inequality. Yet, how should it be possible to reverse this trend while continuing to pursue neoliberal reforms leading to de-unionization and a loss of bargaining power for wage-earners, or to the generalization of firm-based individual wage-setting in which social dumping is recognized as a 'legitimate' (i.e. 'free and fair') form of international competition, or to the intensification of fiscal competition, which prevents the establishment or threatens the stability of a generous system of redistribution?

The emergence of a new regime requires the formation of new socio-political compromises. The neoliberal regime was made possible by the formation of an alliance between financiers, firms' management and skilled workers. This alliance between finance and industry guaranteed high rates of return to capital owners and fast income growth for the wage-earners within the alliance, at the expense of the income growth for the bulk of the labour force. Breaking this alliance to find a new alliance between wage-earners and industry requires a reduction in inequality among workers: in terms of wages as well as risks (health, unemployment etc.). This reduction in inequality can be made possible only by reinforcing social protection, which is still the hierarchically superior institution.[1] This also calls for renewed regulation of the labour market in order to fight the dualism between protected and unprotected workers, increase the general level of protection and re-empower labour.

The crisis should also be an opportunity to get rid of the myth of the post-industrial society, according to which emerging countries would be the world's factories and the OECD countries would specialize in service activities and high-tech. Such an international division of labour is not stable; how could anyone imagine that emerging countries would be kept from R&D activities forever. The recent history of economic development points to an evolution in the industrial specialization of emerging countries from cheap, low-quality products to more sophisticated productions. The example of South Korea indicates the industrialization steps that today's emerging industrialized countries are probably to follow.

[1]On institutional hierarchy, see Amable (2003) and Amable and Palombarini (2009).

Globalization and capital mobility have hindered the industrial development of many OECD countries. Thus, there is a need for active industrial policies, i.e. targeted policies based on a certain degree of protection for industrial projects in their initial phase. This differs considerably from the idea that 'passive' economic policies, ones based on creating certain economic environments, such as competition policy, should be enough. Of course, this does not fit well into the institutional frame of the European Union and its obsession with competition. There, too, a change of paradigm is required.

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How new will the next regulatory regime be?

Robert Boyer

CEPREMAP, Paris, and GREDEG, Sophia-Antipolis, France

Correspondance: robert.boyer@ens.fr

1. Twenty years of 'laisser-faire' orthodoxy challenged

With the victory of the conservative governments of Mrs Thatcher and President Reagan and the triumph of the new classical macroeconomy, the previous regulatory regimes for goods, labour and especially financial markets have been 'reformed', i.e. largely eroded or even dismantled. A new *doxa* had been diffusing all over the world. The idea being that, basically, markets are self-equilibrating, State interventions are the problem and no more the solution: therefore, a light touch approach to regulation has prevailed. It was especially so for finance.

With the collapse of the American financial system after the subprime bubble, the fallacy and danger of such a market fundamentalism becomes clear. First, financial instability and the recurrence of speculative bubbles made an impressive comeback: therefore, an ad hoc State intervention is again welcomed in order to restore one of the first public goods, i.e. financial stability and the credibility of money. Secondly, self-regulation and light touch regulation are considered now as needing to be replaced by an explicit surveillance and control of finance by public authorities in the next national and international regulatory regimes. Thirdly, given the huge costs of bailing out many of the financial entities, economists, analysts and politicians have begun to reconsider their previous beliefs according to which it would be impossible to prevent financial crises but that, on the other hand, solutions to them can be provided, and that public authorities possess the relevant knowledge to act. Do the collapse of Lehman Brothers and the subsequent systemic crisis mean an unprecedented financial divide?

In what direction will the various national mixed economies evolve? A priori several paths are open for developed economies.

2. Converging macroeconomic regulation, monetary and fiscal policy: a first possible new paradigm

Public authorities are not powerless in preventing crises: basically they may adopt strong *anti-cyclical* and *anti-speculation* policies that could be efficient enough to drastically reduce the risk of a major economic crisis generated within the realm of finance (Figure 1).

- On top of the existing regulations at the level of each entity and asset, the State could design a *macroprudential regulation*: a special agency should be in charge

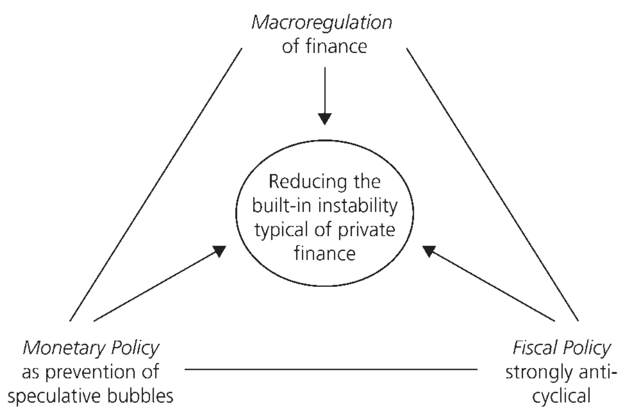

Figure 1 Prevention of a financial crisis by use of typical macroeconomic tools and regulations.

of carrying out, in real time, stress tests of the resilience of the whole financial system in response to the mimetic diffusion of speculation and its bursting and/or adverse macroeconomic shocks, simultaneously affecting all entities. Facing a clear risk of financial collapse, this agency should be given the right to increase capital requirements at an early stage of the speculative boom, however unpopular it might be among financiers.

- *Monetary policy* also has a role to play. When an acceleration of asset prices not explained by a clear rise of real rates of return takes place, the short-term interest rate should be raised, accompanied by a statement of the type: 'Given the Central Bank's current information and analysis, there is a x% probability that the economy is entering into a speculative bubble; if this diagnosis is confirmed by the next set of data it will orient the future decisions about interest rates and refinancing of banks'. The Central Bank may continue to target consumer price inflation and adjust accordingly its interest rate policy but it will increase the reserve ratio of the bank to remove the excessive liquidity that may trigger an asset bubble. Furthermore, these reserve coefficients should be differentiated in order to penalize speculative activities but not the financing of productive investment.
- The third pillar of this macroeconomic approach relates to *fiscal policy*. In the American system, the deduction of interest payments associated with mortgage credit generates a bias towards credit and against saving and this may finally imperil macrostability when this device converts some households into 'Ponzi speculators'. This is also part of the story that led to the subprime crisis. Therefore, there is room for a reform of the tax system that would cancel interest payment deductions and increase marginal taxation for the financial earnings that are in excess of a threshold for the normal rate of return that prevails in the rest of the economy.

3. Redesign the objectives, incentives and tools of finance in order to foster a more resilient system

Hence why not reform the very internal sources of financial instability?

- One of the cornerstones of this second approach relates to the *reform of remuneration* of all financial actors according to the ex post medium-term performance of the related credit, asset or merger; this is, of course, at odds with the previous system. For instance, sellers of mortgage credit should be paid according to the reimbursement flows, thus taking into account the risk of default. Similarly, stock options should be banned since they move according to so many factors that are far away from a direct measure of the contribution to the performance of the firm. Furthermore, they typically promote excessive risk taking (Figure 2).

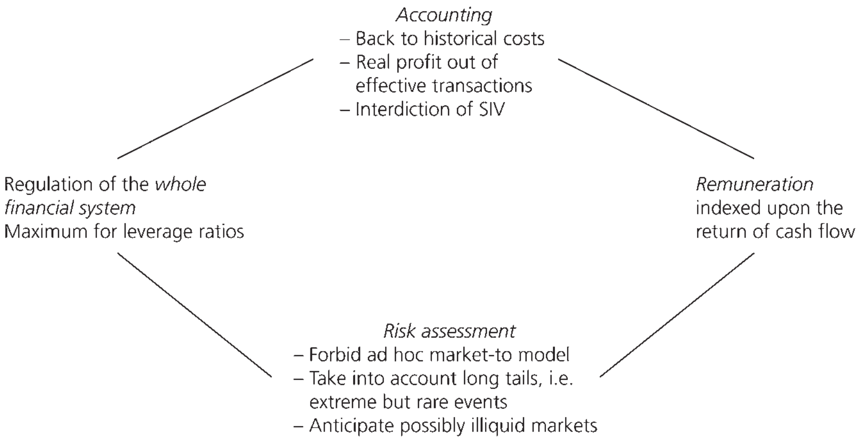

Figure 2 Internally redesigning finance.

This calls for a drastic reappraisal of fair value *accounting principles*. They have a clear responsibility for the size of the bubble and conversely for the collapse of so many banks since they introduced another acceleration mechanism on top of the well-known financial accelerator. Furthermore, it is meaningless to distribute totally virtual profits that would only be generated if the firm would stop its activity and sell all its assets . . . at the current price! It is time to come back to the conventional conception and measure of profit as a value creation, to adopt a modernized version of historical costs once inflation has been drastically reduced.

- The failure of risk assessment using the conventional models of modern mathematical finance calls for the rebuttal of firm-specific model evaluation, and the elaboration of a new generation of risk assessment models that would correct their clear shortcomings as evidenced during the subprime crisis: relatively high frequency of quite *extreme events, endogeneity* of bubbles, need for anticipating a possible *freezing* of markets and access to credit. Financiers should not be entitled anymore to build their own model: a form or another of certification, hence standardization, should be applied.

Finally, the growing interdependency between commercial banks' typical activities and the dynamism and inventiveness of investment banks calls for an *integrated regulation* of the whole financial system. Owing to the fact that, in the USA, Wall Street entities have now been incorporated into the common status of holding banks they benefit from the same access to deposit insurance, liquidity from the Central Bank and credit from the Treasury, they should have to comply with the same reporting rules, surveillance mechanisms, transparency and security requirements.

Easier proposed than actually implemented! This strategy assumes a drastic shift in the bargaining power of national governments and public administrations with respect to the still powerful international finance institutions.

4. Collective control of financial innovations: still another possible paradigm

In the very domain of finance, it took nearly two centuries to design and implement regulations to prevent the bank runs that used to threaten the basis of any market economy: the resilience of the monetary system. *Mutatis mutandis*, the task of public authorities is nowadays to invent rules and mechanisms in order to prevent the collapse of modern financial systems under the unexpected feedback of a bunch of powerful, but potentially dangerous, innovations, such as securitization allied with complex derivatives (Boyer, 2008). The task is to invent for investment bank activities the equivalent of that which has been done in the past for commercial banks (Figure 3).

How to prevent the repetition of the 2008 collapse? First, it has to be recognized that granting credit to people unable to pay it back was a highly profitable idea for the originators only because securitization was shifting the risk to less-informed agents. Regulators should have forbidden such myopic risk transfer. Subprime holders were betting upon an unlimited rise of real estate prices: it was thus transforming them into 'Ponzi speculators' and it is well known that such a scheme is bound—with probability one—to burst. The governments that maintained strict rules concerning mortgage credit, such as Canada or Germany, did not at all experience the same trajectory as the USA.

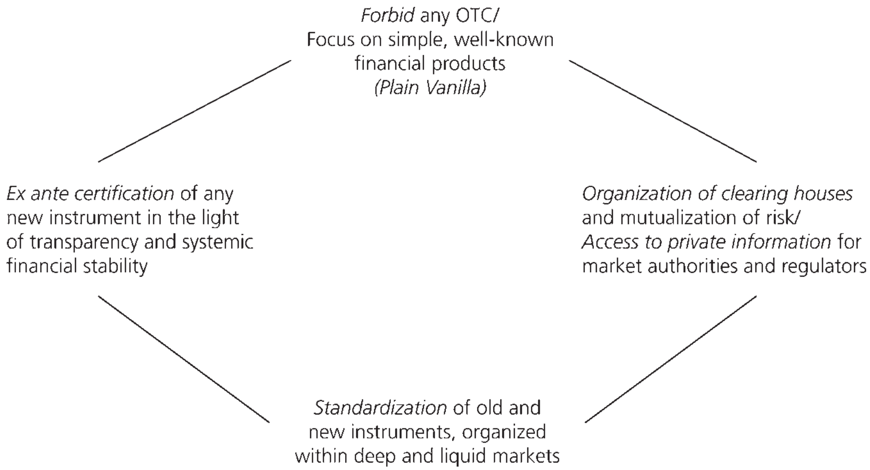

Figure 3 Collective control of private financial innovations.

Consequently a third regulatory paradigm would focus upon financial innovations and propose an *ex ante* certification of new instruments, standardization of a limited variety of these instruments, organization of clearing houses with mutualization of risk, real-time access by regulatory agencies to the full information generated by deep and liquid markets, and finally an interdiction of the sale of Over the Counter Products to badly informed agents.

5. The search for a new institutional architecture: a response to a systemic and structural crisis

The previous analysis focused mainly on the domain of finance and its relationship with public interventions. Nevertheless, the deep and long-lasting economic crisis that was derived from the quasi-collapse of the American financial system calls for a wider analysis (Boyer, 2009). Was not the subprime invention a trick to overcome the long-term stagnation of the real income of the less privileged fraction of the population? Has not the global 2008–2009 recession shown that the international system has drastically changed under the opening of most economies to trade, direct investment and finance? This is an invitation to shift from a microapproach to *regulation* to a macroanalysis of the role of different financial systems in the dynamism and resilience of growth regimes, i.e. *régulation* in the French meaning (Boyer and Saillard, 2001).

Clearly, the profit motive has had an obvious responsibility concerning the succession of financial crises and the power acquired by finance, while liberalization and globalization have induced high finance to engage in predatory strategies. In a sense, this is a Polanyian type of crisis: the full commodification of finance has led to the collapse of its fundamental pillar, i.e. trust. It is conceivable that there could thus emerge a totally different conception of finance: the management of a public service, named access to credit and money, would be delegated to the banks and other entities (Lordon, 2009); their governance structures should give a voice to each stakeholder (credit holder, depositor, wage-earner, citizen, communities, State etc.) in order to mitigate the absolutism of the profit motive (Figure 4).

Basically, credit should no longer be a substitute for poor and stagnating incomes. Consequently, the power of labour at the firm level should be strengthened, either by a reform of the governance of non-financial firms, or by a public control of capital remuneration. Last but not the least, the weakening of workers' bargaining power is itself the outcome of the pressure exerted by foreign competition, the high mobility of capital and the overcapacity in production associated with the entry of China, India and other emerging countries into world competition. Disciplining international relations by interregional negotiations would open a new phase of internationalization, better accepted by workers and citizens than the present unintended effects of large interdependence without clear collective rules (Lordon, 2009).

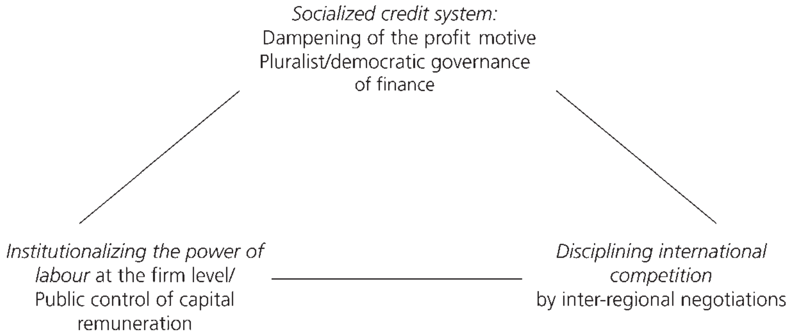

Figure 4 Finance as a public utility, reinstituting some of the power of workers and a new deal for international relations.

Such a path is far from a mechanical derivation stemming from the present state of the world economy, but the rupture of some of the past determinisms makes it less irrelevant than in the past. Everything is up to the collective actors' ability to start the exploration of such a reconfiguration of national economies and international relations.

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Three narratives of the global economic crisis

David Levi-Faur[1,*] and Christine Parker[2]

[1]*Hebrew University of Jerusalem, Israel*
[2]*University of Melbourne, Australia*

**Correspondence: levifaur@mscc.huji.ac.il*

The global economic crisis of 2007–2009 has given a regulatory governance theory 15 min of fame. It is a brief moment in which it is glaringly apparent to almost everyone that we need to rethink how capitalism is governed and how it should be mended or even redesigned. Policy conversations and political commentaries all over the globe are suddenly concerned with regulation: blame for regulatory failure, plans for regulatory reform, and also, surprisingly enough, a reassertion of deregulatory zeal. Two narratives are vying to dominate the understanding of why the crisis happened, and how to shape post-crisis governance: the narrative of denial and the narrative of recanting neoliberalism. We suggest that a third narrative, regulatory capitalism, may guide us best in our efforts to understand the current regulatory crisis and the governance of capitalism.

1. The narrative of denial

The narrative of denial continues to advocate deregulation and unfettered markets, even while admitting some policy mistakes were made in the past. In the pages of the *Cato Journal* and *The Economist*, for example, blame for the crisis is directed mainly at governments and bureaucracies for the way they planned and implemented policies of deregulation, or, rather, failed to deregulate enough. Now they are worried that the crisis has prompted the growth of 'state capitalism' and strengthened 'moral hazard'. In this narrative, the recanting of neoliberal policies is minimal at best. After all, when ideas are transformed to policies, they are prone to mistake and abuse. Thus it is the implementation rather than the ideas that must be re-assessed. More importantly, however, this narrative does not re-assess one of the dominant pillars of regulatory theory, namely the capture perspective of the Chicago school's 'private-interest' or 'economic' theories of regulation. This perspective on regulation is best captured by George Stigler's powerful dictum:

> Regulation is acquired by the industry and is designed and operated primarily for its benefit. (Stigler, 1971, p. 3)

The theoretical, analytical and factual limits of this dictum were questioned from its very inception and from various angles and perspectives (Wilson, 1980; Croley, 2008). Yet, the dictum had a powerful hold on the public imagination, especially among political and policy elites in the USA since the 1970s. It became a core principle of scholarly and policy communities around the world, and was transformed from a research assumption or hypothesis to a central dictum of the neoliberal policy creed (Hobsbawm, 1994). Stigler's formulation is not necessarily an economic theory of regulation. It is also, or even mainly, a theory of politics that suggests that politics is about the maximization of power via the capture of law, in general, and regulation, in particular. In this way, Stigler's denial narrative reduces politics to power, exogenizes interests and desocializes preferences. Yet, logic dictates that if regulation is 'acquired by industry', so too is 'deregulation'. Indeed, experience shows that, in some cases, maybe most cases, specific 'deregulatory' legislation was captured by industry and, in Stigler's language, 'designed and operated primarily for its benefit'. Thus we can turn Stigler on his head and suggest that:

> Deregulation is acquired by industry and is designed and operated primarily for its benefit.

We might go on to acknowledge that much of the regulatory reforms that were called 'deregulation' for political purposes were in fact 'reregulation' (Levi-Faur, 2003). It is therefore even possible to turn Stigler on his head again and suggest that:

> Re-regulation is acquired by the industry (masked often as 'deregulation') and is designed and operated primarily for its benefit.

Thus, regulation, deregulation and reregulation are all prone to strategic capture: they are essentially strategic tools that are employed for the benefit of the few at the expense of the silent, disenfranchised public. The denial narrative in Stigler's popular formulation brings us therefore to a dead-end: Whatever we do in the political arena will end, by definition, with failure. Salvation, according to this narrative, is best found by disembedding economics from politics and society, and empowering mechanisms of governance.

2. The narrative recanting neoliberalism

The second narrative, 'recanting neoliberalism', celebrates the emergence of a different variety of capitalism in the wake of the global economic crisis—one that is more Keynesian and less Moneterian, more European and less Anglo-Saxon, one that reinforces the welfare state rather than seeks its demise, one that *re*embeds 'disembedded markets'. Joseph Stiglitz (2009), for example, traces the landmarks in the path that led to the global financial crisis in the USA, including the appointment of an 'anti-regulation' advocate, Alan Greenspan, as Chairman of the Federal Reserve Board in 1987; the repeal of the Glass-Steagall Act in 1999; and an array of further deregulatory and self-regulatory reforms:

> The truth is that most of the individual mistakes boil down to just one: a belief that markets are self-adjusting and that the role of government should be minimal .... The embrace by America—and much of the rest of the world—of this flawed economic philosophy made it inevitable that we would eventually arrive at the place we are today.

We suggest that the recanting neoliberalism narrative may turn into a comforting fairytale. It allows us to feel that we have clearly pinpointed the blame for a major catastrophe, and tells us (too simply) what we can do to fix the problem: return to regulation with a dose of state socialism backed up by Keynesian policies. Yet, Keynesianism does not solve the problem of how to design, apply, monitor or enforce rules. It is, at most, a return to the politics of distribution and re-distribution. The Keynesian emphasis on scale of investment and on the fiscal tools of government does not suggest how, when and by whom regulation should apply, nor how systems of regulatory governance should be reformed. The injection of public money to ailing economic giants who are 'too big to fail' is a classic policy means. It is of little significance whether there is temporary nationalization of the corporations or not, so long as the regulatory institutions that govern the operation of these corporations do not change.

The narrative of 'recanting liberalism' is also problematic because it does not acknowledge the degree of regulation that was actually in place during the so-called neoliberal age of deregulation and unfettered capitalism (Levi-Faur, 2005; Jordana *et al.*, forthcoming). Because it refuses to acknowledge the fact that the golden age of deregulation was in fact the golden age of regulatory growth, it does not develop or assess the current regulatory theories. It assumes that government regulation is the solution (since deregulation was the cause of the problem), without having to assess how or where previous attempts at regulation went wrong. At the theoretical level, this narrative adopts again 'public interest' theories of regulation that assert:

> Regulation is *not* acquired by industry and is designed and operated primarily for the benefit of the *public*.

This dictum which is deeply embedded in any call for political reform does not recognize how contested the very concept of the public interest is. Nor does it recognize that not all actors (including public actors) seek the public interest, what ever it is. The 'recanting neoliberalism' narrative, mostly advocated by scholars of political economy and socio-economics more generally, has not yet developed a specific political economy or socio-economics theory of regulation. This is its great weakness: we are asked, even if implicitly, to accept regulation as a solution, and to believe that the public interest will rein in private ones, and that our agents—politicians, bureaucrats, regulocrats—will serve the public interest. It is not clear, however, why we should accept this solution and embrace theories of public interest after so many years when they were considered naïve and simplistic.

3. The narrative of regulatory capitalism

The third narrative draws on both institutional theory and Polanyi's (1957) notion of the embeddedness of markets in society to characterize the current governance institutions as 'regulatory capitalism' (Levi-Faur, 2005; Braithwaite, 2008; Wright, 2009). This narrative is concerned with understanding the growing tendency of various actors to rely on regulation as a tool of governance. It differs from the narrative of denial in that it does not accept instrumental action (or the logic of interest maximization—and therefore capture) as the primary mode of political action. Rather it attends to the role of regulatory institutionalization as a major mechanism of economic, social and political rationalization. Unlike the narrative of 'recanting neoliberalism', regulatory capitalism, thus, acknowledges the fact that the last 30 years have not been a deregulatory zone. Regulatory capitalism points to the growth in scope and impact of regulation of all kinds at the national and global levels. It focuses attention on the growing investments of political actors—states, international organizations, business of all kinds and civil actors (such as NGOs and advocacy groups)—in regulation, in general, and regulatory strategies to address particular problems, in particular. 'Regulatory capitalism' denotes a world where regulation is increasingly an hybrid of different systems of controls: étatist regulation co-evolves with civil regulation; national regulation expands with international and global regulation; private regulation co-evolves and expands with public regulation; voluntary regulations expand with coercive ones; and, the market itself is being used or mobilized as a regulatory mechanism.

The narrative of 'recanting neoliberalism' assumes that we can easily identify public interest regulatory strategies that will 'work'. The challenges are both ideological and political—to convince people and narrow interests to give public interest regulation a chance (Rudd, 2009). Regulatory capitalism, in contrast, suggests that developing reflexive understanding of *how* regulation works and how to combine different strategies, types and forms of regulation is a challenge we still have to recognize (Parker and Nielsen, 2009).

Regulatory capitalism says that to understand the global economic crisis, and the crisis in the relations between economics, politics and society, we need to be more attentive to the particular characteristics of regulation as a mode of governance. Instead of regulation (as if we are imagining one rule, set in one point in time and in one decision point), we should consider a system of rules and decision-making procedures and arenas that we can call regulatory governance. In particular, the global economic crisis must be understood in light of the complexity of the financial regulatory system, its rapid growth in the last 20 years, the tight coupling of its various institutions, the tensions between the need to rely on more and more strict regulation, on the one hand, and the strong belief (and advocacy) of deregulation, voluntarism and self-governance, on the other. The narrative of regulatory capitalism acknowledges that in general our regulatory systems look like Swiss cheese—strict rules governing some parts and no rules at all for others (Partnoy, 2003). If this is true at the national level, it is even more so in the context of the rapid expansion of the global financial systems which made financial governance, a Swiss cheese to start with, more holes than cheese. In this narrative, systemic failure is more than a failed decision in one agency or another. It is more than the reckless behaviour of some of the actors (investment banks, especially), or even the long-term effects of three decades of neoliberalism. It is not about blame-shifting, blame-accounting, blame assessment and blame-implementation. It is more about blame-sharing, a recognition that accidents are a natural feature of the system and yet they can be restrained and tackled (relatively) successfully using combinations of plural regulatory strategies (Braithwaite, 2009; Murphy *et al.*, 2009; Nielsen and Parker, 2009).

To summarize, although the effects of the collapse of the US financial system and its effects all over the world are still visible, we have not yet seen any radical change in the way government and, in particular, the US government responded to the crisis. Both the denial and recanting narratives have serious shortcomings. Indeed, we are sceptical that anything significant will change following the global economic crisis. The main enemy is hubristic theories: hubris of causality and hubris in regards to what we really have at the moment as a system. We cannot and never will be able to 'design' a perfect system from scratch. But we can better understand how regulatory governance works, and use this as a basis for ongoing, reflexive reform. Yet, this will not change the situation significantly. The cheese will continue to have holes all over. New holes will emerge where and when we cover old holes. This brief moment in time might be enough to come up with new ideas but not to produce a real new consensus about neither the desired world economic and political order nor about the direction in which regulatory capitalism and regulatory governance more generally can and should develop.

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A socio-economic perspective on the financial crisis

Steven Vogel

University of California, Berkeley, CA, USA

Correspondence: svogel@berkeley.edu

For aficionados of socio-economics, this is the best of times and the worst of times. On the one hand, we can savour the exhilaration of having real-world events demonstrate that we have been right all along. On the other hand, we confront the terrifying possibility that this very success could render us less relevant—or something even worse: almost mainstream. That is, prior to the latest great financial crisis, it was still quite heretical to suggest that markets require regulation for their own good and not just for the satisfaction of anti-capitalist bleeding hearts; or to assert that effective regulation requires a holistic approach rather than a minimalist one. Yet to make such assertions at this point in time seems almost banal.

I would contend, however, that the socio-economic approach remains safely outside the mainstream, even today. The SASE website states that socio-economics assumes that the economy is embedded in society, politics and culture; that social context enables competition as well as constrains it; and that social order is necessary for markets to function efficiently (SASE, 2010). While there may be rough agreement on these points within the halls of a SASE conference, there is still no such consensus out there in the real world of politics and markets, despite a marked shift in tone and rhetoric over the past 2 years. Most policy-makers and commentators still frame regulatory debates in terms of a dichotomy of government *versus* market rather than different blends of government *and* market. They remain wedded to a rhetoric that suggests that governments 'intervene' and 'distort' markets, and that 'deregulation' implies more effective markets and not less.

Ironically, there is an emerging consensus in the study of development and market transition that governments must actively create and sustain market institutions (Stiglitz, 2002; World Bank, 2002; Rodrick, 2007), yet there is less appreciation for this basic insight in the study of those countries where those institutions are most developed. The advanced industrial countries already have market institutions, so there is less recognition that one would need to enhance these institutions—rather than dismantle them—in order to promote market competition. What would it take for Japan, for example, to move in the direction of a liberal market economy, with more active labour and capital markets? This would require not a removal of regulatory constraints but rather a substantial build-up of market infrastructure, including laws and regulations, coupled with a transformation of private sector practices and social norms (Vogel, 2006, pp. 4–7).

Moreover, the differences among ways of conceiving market institutions really matter, both for analysis and for policy. Even classical liberals and 'neo-liberals' concur that markets require rules, including the rule of law and the protection of private property. Beyond that, standard economics teaches us that market failures provide the primary justification for government regulation. But a socio-economic perspective ventures further and posits that regulation in an advanced economy is not an appendage to the market but a constitutive element of the market. In many realms, such as modern finance, regulation creates, sustains and defines markets.

The rather straightforward proposition that modern market systems require an institutional infrastructure logically begets some less obvious ramifications. It implies, for example, that liberalizing markets does not mean liberating them. More liberal markets—in the sense of more competitive markets—require more governance and not less. And the most sophisticated markets—in the sense of more complex, more efficient and more technologically advanced markets—require more governance and not less. In fact, some of the most sophisticated markets today, such as credit default swap markets, are fabrications: they are consciously designed products of governance rather than spontaneously evolving institutions that have merely been enhanced by regulation over time.

Likewise, if we take the notion of markets as institutions seriously, then the alternative to one form of market governance is not the free market but rather another form of market governance. Policy debates over regulatory issues remain framed as contests between government and market, and yet more often the actual substance of the debates is one of *market design*: more effective regulation versus less effective regulation, or regulation that favours one group of market actors (incumbents, managers, copyright holders) versus another (challengers, shareholders, copyright users; see Landy *et al.*, 2007).

So, what does all this have to do with the financial crisis? While I would not venture to assign weights to the multitude of factors that have contributed to the crisis, I would argue that flawed conceptual frameworks have played a substantial role. Here we have another irony: for all the overwhelming complexity of the crisis, some fairly pedestrian policy errors were at the heart of the storm. The US financial authorities made the basic mistake that lies at the heart of most recent financial crises: they liberalized financial markets in the sense of giving market actors greater freedom to take risks without strengthening supervision to monitor this activity effectively and to contain the risk to the broader financial system. In addition, they presumed that the most sophisticated investors, large financial institutions, should be allowed considerable freedom to take these risks because they were professionals with deep pockets, and because this activity would enhance the efficiency of financial markets overall. They engaged in piecemeal deregulation, removing restrictions in one area of financial activity without fully considering the impact on other markets. And they overestimated the capability of private sector actors—from rating agencies to self-regulatory organizations—to regulate in the public interest. In short, they committed basic errors of market design.

In 1998, for example, US government officials debated the regulation of over-the-counter derivatives. Brooksley Born, the Chair of the Commodity Futures Trading Commission, questioned the regulatory exemption for derivatives, given the considerable risks posed by these instruments and the rapid growth in the market. The opponents of regulation—including Treasury

Secretary Robert Rubin, Deputy Treasury Secretary Larry Summers, Securities and Exchange Commission Chairman Arthur Levitt, and Federal Reserve Chairman Alan Greenspan—prevailed. They argued that the CFTC did not have the statutory authority to regulate the industry; that the CFTC had not made a compelling case that market developments warranted a shift to regulation; and that regulation could destabilize financial markets.

We can conclude, therefore, that a new economic paradigm in the wake of the financial crisis should appreciate the practical ramifications of a socio-economic understanding of markets. Such a new paradigm would shift the debate from governments versus markets to one of market design; it would seek to optimize the governance of real-world markets, embedded as they are in the messy reality of society and politics, rather than theoretical markets; it would aim for the most effective blend of government regulation and private sector governance; and it would view markets as an integrated whole rather than as discrete segments. The financial crisis will not, and should not, deliver a death-blow to a market liberal perspective on political economy. But one would hope that it would undermine the more naïve and simplistic versions of this perspective. That is, those who believe most in the virtues of markets should want those markets to be well designed, and that means effectively regulated and governed.

Returning to the title of this panel, do we find such a new economic paradigm emerging? In a word, no. The advanced industrial countries experienced very different economic crises, and their governments operate within very different political and institutional contexts. So they have responded to the crisis in very different ways. In the USA, the financial sector was at the heart of the crisis, and the Obama administration has made financial reform a major priority. The government is moving forward with an overhaul of the financial regulatory apparatus, although critics suggest that the administration is too closely tied to the financial sector to impose appropriate regulatory solutions. In light of popular outrage over the financial bailout, the administration has proposed measures to force financial institutions to compensate the government for the bailout, and to crack down on executive compensation schemes in the financial sector.

In Japan, the crisis was less of a failure of financial regulation and more one of plummeting demand for exports. Japan had already experienced its own financial crisis in the 1990s, so the government had been through one round of financial reforms and the financial institutions had been substantially restructured. And in any case, Japanese financial institutions were less exposed to risky investments than their American counterparts. Japan had its own watershed election in August 2009, with the Democratic Party of Japan (DPJ) decisively ousting the Liberal Democratic Party (LDP), which had dominated Japanese politics for more than 50 years. And yet the DPJ administration has to date failed to develop a clear economic strategy, and it certainly has not made financial reform a priority. For all of the new government's rhetoric about seizing control from the bureaucrats, it has left the financial authorities largely to continue with regulatory business as usual.

Some observers have suggested that even this great financial crisis was not big enough to provoke a fundamental shift in the neo-liberal trend of the past few decades. The policy debate has changed, nonetheless, even if the shift is not big enough and the solutions are not satisfactory. While a socio-economic perspective may still not be mainstream, its core precepts play a more prominent role within policy debates than they did two years ago.

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