Saving the Market from Itself

The 2007–2009 financial crisis threatened economic disaster on a scale not seen since the Great Depression, but rapid state action prevented the widely feared devastation. The German response was considerably more generous to banks than the American or British bailouts were. Drawing on author interviews and primary sources in government, private firms, and media, Mitchell explains how the structure of national financial systems and interbank relationships produced extensive private rescues and pressure on different states. Mitchell explores the different responses and results in Germany, the United Kingdom, and the United States using a combination of detailed case-study analyses of the three countries' responses to the crisis and a quantitative analysis of patterns of state responses to financial crises. This book will be essential reading for scholars and advanced students of political economy, comparative politics, economic sociology, economics, and public policy.

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The Politics of Financial Intervention

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To my wife Elizabeth, without whom I never would have made it this far.

To Henry Stender, who so wanted to see this book in print.

To my mother, for her love and support.

Contents

Figures and Tables

Figures

Tables

Preface

The 2007–2009 financial crisis demonstrated once again the potential for enormous devastation in a capitalist system, and that even the most advanced economies are not immune to potentially catastrophic crises. It also demonstrated how states are willing to spend massive sums of money to contain financial crises. Given the potential devastation from an uncontained financial crisis, spending even billions of dollars, euros, or pounds may be justified. However, while the public will be universally hostile to such bank bailouts, not all bailouts are created equal. Some states, such as the United States, constructed their rescues in such a way that the state recouped the vast majority of taxpayer money invested in saving the banks. Others, such as Germany, adopted policies that were much more generous to bankers and were never designed to, nor in fact did, recover a significant portion of taxpayer funds.

This project had its genesis in the very heart of the financial crisis, as I closely followed the development of rescue plans in the United States and Europe. Although much of the business literature and academic literature had emphasized an increasing convergence in global business and regulatory practices, the affected states adopted at times strikingly different policies. This project, therefore, was devoted to explaining why such divergent policies came about and whether they could be explained simply as a product of individual leaders in power or driven by deeper structural forces. What eventually became clear is that the extent of convergence has been overstated. Even if divergent financial systems have moved closer to each other, they retain key differences, especially in the political clout of banks and bankers in times of crisis. As such, financial crises, rather than deepening convergence, in fact reinforce diversity in national financial systems. Moreover, they do so in a way that has significant impact on the long-term costs to the state. Although the public is universally hostile to bailouts regardless of the specific forms, and although all affected states can be expected to invest significant public money in containing the crisis, the nature of the national financial system will play a key role in determining the shape of the rescue, the costs to shareholders, and the likelihood of the state recovering its funds.

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Abbreviations

ABA	American Banking Association
AIG	American International Group
APS	Asset Purchase Scheme
BaFin	*Bundesanstalt für Finanzdienstleistungsaufsicht* (Federal Financial Supervisory Authority)
BdB	*Bundesverband deutscher Banken* (Federal Association of German Banks)
BVR	*Bundesverband der Deutschen Volksbanken und Raiffeisenbanken* (National Association of German Cooperative Banks)
CDO	Collateralized Debt Obligation
CDS	Credit Default Swap
CDU/CSU	Christian Democratic Union/Christian Social Union
DSGV	*Deutscher Sparkassen- und Giroverband* (German Savings Banks Association)
DSW	*Deutsche Schutzvereinigung für Wertpapierbesitz*
ECB	European Central Bank
FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FSA	Financial Services Authority
GSE	Government-Sponsored Enterprises
HBOS	Halifax Bank of Scotland
HSBC	Hong Kong and Shanghai Banking Corporation
IKB	*Industrialkreditbank*
KfW	*Kreditanstalt für Wiederaufbau*
LBBW	*Landesbank Baden-Württemberg*
LTCM	Long-Term Capital Management
OCC	Office of Comptroller of the Currency
OFHEO	Office of Federal Housing Enterprise Oversight
OTS	Office of Thrift Supervision
RBS	Royal Bank of Scotland

SDP	Social Democratic Party
SEC	Securities and Exchange Commission
SLS	Special Liquidity Scheme
SoFFin	*Sonderfonds Finanzmarktstabilisierung* (Special Financial Market Stabilization Funds)
TARP	Troubled Asset Relief Program
UKSA	UK Shareholder Association
WaMu	Washington Mutual