

Reluctant Regulators

How the West Created
and How China Survived
the Global Financial Crisis

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Introduction — Reluctant Regulators

The crisis that overtook the world's financial markets in 2007 was a disaster that ought not to have occurred. Never had the defences against worldwide financial instability and global recession seemed so strong. The world economy was enjoying both rapid economic expansion and a general freedom from inflation. This achievement had reinforced the consensus among advanced and emerging economies that markets were more efficient than governments in fostering sustained and stable growth and in ensuring a better deal for consumers in terms not only of prices but of quality and choice as well. As an additional reassurance, the world's central bankers had reached agreement on the regulatory measures that would minimise the risks of institutional failure and restrain the spread of financial instability from one country to another.

Financial crises frequently start with what appears to be a relatively insignificant and isolated market misfortune.¹ So it was in 2007. At first, the initial tremors seemed minor events that could be comfortably contained. They began with a collapse in confidence among investors holding the US\$200 billion of securities issued by the American sub-prime mortgage market. Zhou Xiaochuan, Governor of the People's Bank (China's central bank) observed at the time that there was no reason for general panic because 'it should not be hard for an economy as large as the U.S. to absorb the losses'.² Similarly, it seemed very unlikely that a run on the United Kingdom's Northern Rock Bank in the same year could trigger a general collapse in public confidence. It was so minor a player, senior British officials later suggested, that it seemed to be hardly worth saving.³

More improbable still were the catastrophic consequences of the American decision to let Lehman Bros fail the following year. The direct losses that this event would cause were described as 'relatively modest'. But the markets went into total panic. 'Banks hoarded liquidity for fear of lending to infected banks', a central banker later lamented, 'and there was an effective boycott of the remaining large US investment

banks'. How could such incidents disrupt international financial centres that had been tested to destruction in the previous decade and emerged intact? In the ten years from 1997, the world financial system had 'stood tall ... self-regulating and self-repairing' even in the face of 'oil prices shocks, wars and dotcom mania'.⁴ Yet, without warning, it seemed, calamity struck on a scale that appeared beyond all normal experience or reasonable expectations.⁵ Observers scrambled to find parallels sufficiently apocalyptic.

Between summer 2007 and early 2009, the global financial system suffered its worst crisis for at least 70 years, indeed in some ways the worst crisis since the emergence 200 years ago of modern industrial capitalism. And this financial crisis — largely the product of developments within the financial system, not events imposed from without — has generated a severe global recession.⁶

End of a golden era

The crisis was global but its origins were very much an Anglo-American affair. The United States and the United Kingdom dominated the financial world and its regulation, and New York and London were the largest international financial centres. On the very eve of the crisis in 2007 financial officials in Washington and London were taking credit for having created a monetary environment that had allowed world GDP to rise by 80 per cent since 1990.⁷ They expressed satisfaction at the way their banking systems had displayed an ability to withstand severe strains caused by changing trade patterns, sharp swings in business cycles and direct threats to national survival.

The last decade has seen some big and unanticipated changes. Since 1999, oil prices have risen from below \$20 a barrel to over \$70 a barrel, the US Fed funds rate has varied between 1% and 6.5%, and the stock market has experienced its post dotcom boom, bust and recovery, with the FTSE All Share falling from its 2000 high of over 3200 to below 1660 in 2003 before now recovering to over 3400. We have seen 9/11 and the onset of a new form of international terrorism, the explosive growth of new financial instruments and new players to exploit them, and we have seen the emergence of China and India into major forces in the world economy.⁸

Even as they made these boasts, the warning signs of impending disaster were already almost a year old, but American and British officials could not believe that this golden age would wither. In the second quarter of 2006, financial institutions had begun 'to liquidate portfolios to meet margin calls or solvency requirements', which caused significant funding problems. The Bank of England linked this trend to

mounting competition in financial markets ‘to stay ahead of, or keep up with, the pack [which] stretches risk management systems in the process’. No special response was deemed necessary, it was explained, because officials remained completely convinced that the markets were self-correcting.⁹ In addition, officials were to argue later, ‘one would need to be endowed with perfect foresight to have been able to predict how the financial crisis would unfold, spilling over from one institution to another, and from one market to another’.¹⁰

By 2008, market failures and corporate collapses had imposed enormous burdens on American and British citizens as budgets shrank and taxes rose. In the United States, the sums allocated to the Troubled Asset Relief Program (TARP), the government’s first rescue package, could be described only in epic terms.

The \$700 billion TARP program alone is worth more, in inflation-adjusted dollars, than the combined cost of the Hoover Dam, the Panama Canal, the first Gulf War, the Marshall Plan, the Louisiana Purchase, and all of the moon missions. Multiply that ninefold, and you have the current running total of the federal government’s economic rescue programs.¹¹

The effects of the global crisis on the public finances of the United Kingdom were no less dramatic. ‘Fiscal deficits have widened sharply and are expected to be about 13 percent of GDP in 2009 and 2010’, the IMF reported, ‘Gross general government debt is set to double over the next five years to nearly 100 percent of GDP’.¹² The impact on the capitalisation of the British banking industry was catastrophic. The value of its shares had risen by an annual average of 16 per cent from 1985 to 2006 (compared with only 2 per cent a year in the period 1900–84). They then slumped. By March 2009, they had lost 80 per cent of their cumulative value, a bigger fall than even during the Great Crash in 1929.¹³ ‘The costs of this crisis will be with us for a generation’, the Governor of the Bank of England predicted.¹⁴

Anglo-American Armageddon

This crisis seemed all the more cruel because of the surprise with which it struck the United States and the United Kingdom. The pain they suffered was similar in scale to that of other advanced economies.¹⁵ But for these two countries, 2007 was Armageddon,¹⁶ a disaster in total contrast to the prosperity and stability that they had achieved over the previous 30 years and that had been widely enjoyed by so many other nations which had adopted their economic convictions. What made the 2007–09 market turmoil and the financial trauma truly apocalyptic was the vulnerability uncovered in New York and London, the world’s two

largest international financial centres. The paradox was that ‘financial fragility and occasional financial crises’ ought not to have come as a shock because such events were already well-researched side-effects of the liberal financial régimes that American and British policy-makers favoured.¹⁷ They were the price of progress, it had been claimed previously, and would be well compensated for by faster long-run growth.¹⁸ Bank runs and market collapses were supposed to happen to other people, however. The Anglo-American view was that ‘systemic financial crises were seen only in history books and emerging markets’, Charles Bean, Deputy of the Bank of England subsequently confessed, ‘they were unlikely to happen in advanced economies with their developed and well regulated financial markets’.¹⁹

The arithmetic of the 2007–09 disaster was not extraordinary, nevertheless. The damage seemed well within the parameters for financial crises since 1970, according to IMF calculations. Total losses for advanced countries as a group were sharply lower in 2007–09 than the average costs they had incurred in financial crises between 1970 and 2006. (See Table 1) Total losses for all countries were higher than in the earlier period, but not dramatically so. Thus, the ‘Conclusions’ will argue, the crisis proved both affordable and manageable for the financial markets themselves, and they made a rapid return to profitability. The New York securities industry, for example, reported record profits in 2009 of over US\$61 billion, ‘almost triple the level of three years earlier’.²⁰ As a result, the impetus for a radical overhaul of financial regulation weakened once governments had successfully intervened to stabilise the markets even though the economic and social costs of the global crisis were painful in the extreme (with the most severe fall in British real wages since the 1920s, for example).²¹

Table 1

Total Costs of Banking Crises, 1970–2009 (direct fiscal costs, increased public borrowings, output lost)²²

	Percentage of GDP	
	Banking Crises 1970–2006	Banking Crises 2007–2009
Advanced Countries	72.8	55.8
All Countries	45.8	53.3

Several of the main features of 2007–09 matched events that had triggered past financial crises — asset price bubbles, for example, and credit booms. The IMF post-mortem reported some novel new features which increased the scale and severity of the 2007–09 crisis: notably, opaqueness as ‘securitization and innovative (but complex) financial instruments’ proliferated and the effects of globalisation.²³ These were

to a large extent the special contribution of New York and London and their light-touch regulators.

Studies of the recent past, with their implicit promise that future growth would bring more than adequate compensation for current losses, were misleading. This article of faith depended on the assumption that American and British financial officials could maintain the stability of their own systems, which had previously seemed a very likely scenario. From the 1990s until 2006, the American and British economies had appeared to have put behind them the previous period's monetary instability when regular inflationary and budgetary setbacks had disrupted growth. The two countries had looked forward to a prospect of unbroken prosperity glowingly described in an official, post-crisis British report.

The period since the economic downturn of the early 1990s, which affected almost all developed countries, came to be known as the 'great moderation' in the United States and the 'great stability' in the United Kingdom ... characterised by low and stable global inflation, as well as high and stable global real GDP growth over the past decade.²⁴

When New York and London turned fragile, the world's two largest financial centres could not avoid exporting contagion on an unprecedented scale. The United States, for example, accounted for 31 per cent of global financial assets and 62 per cent of global reserve currency assets in 2007.²⁵ Neither the United States nor the United Kingdom could look to a ready external lender of last resort to bail them out, which aggravated the collapse in market confidence.²⁶ For the Eurozone, by contrast, the European Central Bank could take on this role after its banks suffered a fall in market confidence almost identical with that in the United States.²⁷ In consequence, the European Central Bank was able to respond to the tests of highly vulnerable economies (notably Ireland) and political unrest that added to the financial turmoil (in Greece in particular) much better than might have been expected, despite a rise in anti-EU sentiment and a loss of popularity by leading political personalities in Europe.²⁸

Predictable and preventable?

Almost immediately after the crisis got underway, central bankers and financial regulators were blamed for the mounting disaster. Their attempts to defend themselves were unconvincing. The recently retired Chairman of the Federal Reserve Board, the redoubtable Alan Greenspan, allowed himself to be quoted as admitting: 'I got the impression that there were a lot of very questionable practices going on'. His

excuse for not intervening was: ‘What basically does the law mean when it says deceptive and unfair practices?’²⁹ This failure of the officials in charge to take remedial action — specifically in the United States and the United Kingdom — was inspired by what a leading British regulator was later to describe as the ‘Greenspan doctrine’:

... which doubted whether any policy, monetary or regulatory, should or could be used to lean against the wind of irrational exuberance, doubted the ability of the authorities to judge whether asset prices had become irrational, and explicitly assumed that market disciplines and market incentives would control any irrational exuberance before a major crisis was reached.³⁰

This book will show that the risks to financial stability were identified well in advance and deliberately discounted by the officials responsible for financial stability in both the United States and the United Kingdom. Deficiencies in regulatory performance were not so much the outcome of erroneous policies or defective legislation. They were the consequences of an Anglo-American regulatory culture which was convinced of the innate and superior wisdom of financial markets.³¹ Financial officials believed in ‘market self correction, effective market discipline, and that management and boards are better placed than any regulator to identify business system risks’.³² The culture created an environment in which ‘implementation and enforcement of existing regulation was ... too lax, reflecting a steady drift toward a more hands-off supervisory style, where the belief that the private sector “knows best” was permitted to take hold’.³³

Before the crisis, the impressive performance of global financial markets and institutions had seemed persuasive evidence that the dominant Anglo-American regulatory culture was soundly based.³⁴ Over the previous three decades, ‘the global market economy, which requires a global finance system at its core, [had] for all its faults been a better mechanism for delivering rising prosperity to an increasing number of people’, Lord Turner, a leading British regulator has argued, ‘than any other system we’ve ever seen’.³⁵ And yet American and British monetary officials have since admitted that they failed to recognise the mismatch between regulatory protocols and market realities, and ‘the [subsequent] widespread economic damage has called into question the fundamental assumptions ... that have directed our regulatory efforts for decades’.³⁶

A principal theme of this book is the conflict between regulation and growth. On this issue, there is no escape from history. The Anglo-American culture had been shaped by the failure of state planning and controls not only in the former Soviet bloc but also in Western Europe

and the Third World which had adopted such policies in the first decades after World War II.³⁷ The deregulation promoted by the Anglo-American culture was followed by an unprecedented surge in international growth and national prosperity. But the limits of this liberalisation were reached, this book will contend, in 2006. The origins of the international financial crisis will be traced to a conviction among American and British regulators that free capitalist markets must be better judges than bureaucrats of businesses, their performance and their prospects. (The crisis has shown how misconceived was this belief and that markets had hopelessly misjudged large numbers of financial institutions.) China is crucial to this debate because its experiences are a reminder of what inspired the movement for deregulation in the first place: market competition drives modernisation and efficiency far more effectively than state planners can ever achieve. But China also highlights how much modern banking and financial services depend on an effective regulatory system to ensure that the funds they raise from the public are managed with professionalism and integrity in the best interests of depositors and investors. Whenever the regulators are pushed aside, China has shown over the last 30 years, banking losses soar at huge cost to the state and the industry.

Culture and consensus

Chapter 1 will review how American and British financial officials — central bankers and regulators alike — shared preconceptions and convictions that shaped their policies and practices. An Anglo-American culture emerged based on a firm belief that free markets were the best guarantee of sustained high growth, stable prices and currencies and the optimal use of resources, including capital. State involvement in economic affairs came to be regarded as mostly misguided and often counter-productive. The market was seen as having an in-built capacity to penalise inferior performance and corporate mismanagement and, very often, was also depicted as self-correcting and self-policing. This intellectual consensus led to what an official United States inquest into the global crisis depicted as a virtual conspiracy to put financial markets and their activities above the law.

The sentries were not at their posts, in no small part due to the widely accepted faith in the selfcorrecting nature of the markets and the ability of financial institutions to effectively police themselves. More than 30 years of deregulation and reliance on self-regulation by financial institutions, championed by former Federal Reserve chairman Alan Greenspan and others, supported by successive administrations and Congresses, and actively pushed by the powerful financial industry at every turn, had stripped away key

safeguards, which could have helped avoid catastrophe ... we do not accept the view that regulators lacked the power to protect the financial system. They had ample power in many arenas and they chose not to use it.³⁸

Chapter 2 presents studies of four issues that were to be of special importance in undermining the stability of the international financial system: mismanagement of the aftermath of the 1997–98 Asian financial crisis; official misjudgements about property bubbles in the decade that followed; the miscalculations of the rating agencies; and misconceptions about the banking-insurance industry nexus. In each instance, American and British officials reviewed the risks involved and their possibly destructive consequences. The chapter will show that in both Washington and London, officials chose not to interfere with the market and publicly justified these deliberate decisions with almost identical declarations of trust in market forces.

Their confidence was accompanied by considerable scepticism among policy-makers and financial officials about their ability to comprehend modern global financial markets and the financial engineering that designed complex derivatives and directed automated trading. Central bankers and regulators did not see themselves as entirely unnecessary. But they minimised their functions in a sincere belief that investors and entrepreneurs knew their own business best. Chapters 1 and 2 will illustrate how the Anglo-American regulatory culture became a dominant influence on the international financial system as a whole and was buttressed by a consensus shared by increasing numbers of political and business leaders, opinion-makers and academics in the last two decades of the 20th century.

China joins the consensus

In the early years after World War II, governments assumed direct responsibility for economic and social development especially in the Third World where free trade and foreign investment were attacked as a Western strategy to exploit their colonial populations. But state intervention failed to deliver progress and eventually fell out of favour. China was to provide a striking example of how state control lost its credibility and why markets were given their freedom. In 1978 Deng Xiaoping convinced the Chinese Communist Party to accept economic reforms after central planning had conspicuously failed to deliver a standard of living which would buy off rising worker unrest and pacify the rural population.³⁹

Unforeseen was how traumatic the retreat from state controls would be. The general assumption is that Deng Xiaoping and his allies had a

clear blueprint for China's future development when the Party endorsed the principles of modernisation, liberalisation and opening up to the outside world. A prominent Beijing economist warned in 1980, however, that there was no general agreement on what the most urgent challenges were and no well-defined strategy for their solution.

China does not have a complete and mature reform programme. All we have are the views and initial suggestions collected during discussions in various departments and some small-scale, experimental and incomplete reforms.⁴⁰

The managers of industrial plants, especially in heavy industry, found the new situation no less arbitrary and frequently more unrealistic than the central planning of the past, and they were in constant danger of severe censure by Party officials for whatever went wrong. Entire production lines were rendered redundant by the new reform policies, and often factories were abruptly deprived of funds and raw materials.⁴¹ The heavy financial losses involved were transferred almost entirely to the banking system, with disastrous consequences for its solvency (to be discussed in chapter 3).

The task of drafting a comprehensive agenda for a modern banking system and its regulation was made all the more difficult by the political background. In 1978 a campaign by the Finance Ministry to regain control over the financial resources of local authorities and state enterprises was defeated by implacable resistance from lower-level officials who believed that only local enterprises, local initiatives and local autonomy could meet their constituents' needs.⁴² Since central planning and state controls were seen as stifling industry and agriculture, it proved virtually impossible to convince the Party and the state bureaucracies that banking was different and that state regulation was essential to its modernisation.⁴³ The banks, which had kept their accounts in meticulous order throughout the worst excesses of ideological extremism before Mao Zedong's death in 1976, fell victim to the surge in lower-level autonomy in 1978. Bank staff now found themselves deprived of a supervisory role they had managed to retain when the rest of the economic administration had fallen into chaos from 1966 as 'Red Guards' and 'revolutionary rebels' seized power.⁴⁴ Fresh attempts at banking reforms in 1983 made matters worse by reducing still further the ability of the People's Bank to oversee the financial system.⁴⁵ Chapter 3 reviews the fluctuating fortunes of would-be financial reformers in the decades that followed.

Although China's reform process was to be complex, confused and often chaotic, the retreat from central planning and state controls was accompanied by 30 years of high-speed GDP growth during which the barriers to foreign trade and investment were dismantled. Along with

these innovations came a repudiation of the Maoist era's 'self reliance' and other protectionist policies and a new-found sense of common challenges and shared solutions in China's relations with the rest of the world. Attitudes emerged in China that were very close to the consensus described earlier in this 'Introduction', which had led to liberalisation of financial markets worldwide and to the light-touch Anglo-American regulatory culture that became almost universal. This intellectual convergence was highlighted in a remarkably frank 2003 People's Bank presentation to an international audience.⁴⁶

- The Third World — including China — had been at fault for overestimating the extent to which 'the world economic order was discriminatory in nature against the developing countries'. This had led to a misguided retreat into protectionist policies after World War II.
- Endorsed, almost unconditionally, was 'the export-oriented development strategy adopted first by the four "Asian Dragons"'.⁴⁷
- The principle was to be accepted that competition 'brings not only pressure, but also vigor and prosperity'. China's protectionists were criticised for having tried to block imports of electronic goods in the 1980s, for example, the liberalisation of exchange rates in the 1990s and accession to the World Trade Organisation in 2001. They had been proved wrong by the nation's subsequent performance on global markets.

Conflicts and constraints in China

China's direct relevance to the global financial crisis starts with its extraordinary emergence as a major participant in world markets in the first three decades of economic reform.

- In 1978 foreign trade was equivalent to 10 per cent of China's GDP. Foreign exchange reserves totalled US\$1.6 billion⁴⁷ (equivalent to 6 per cent of Japan's holdings; 10 per cent of the United Kingdom figure; and 27 per cent of the Indian total⁴⁸).
- In 2007 foreign trade was equivalent to 67 per cent of China's GDP. Foreign exchange reserves totalled US\$1.5 trillion (the largest in the world from 2006).

The source of these riches was the extraordinary success of China's export industries during the 30 years since Deng Xiaoping introduced the 'open door' policies. Foreign trade had grown by an annual 17 per cent, while the share of industrial products in exports rose from half to 95 per cent over the period. The economy had become integrated into the global economy not just in terms of external market transactions but also through the revival of foreign ownership in this key growth sector.

- In 1978 all external trade and financial transactions were under state control.
- In 2007 firms owned wholly or partly by foreigners accounted for 54 per cent of China's total foreign trade.⁴⁹

China's growth has thus depended on its ability to conform to international practices and procedures, covering banking transactions as well as customs and other formalities, which helps to explain the approach to financial modernisation reviewed in chapter 3. This chapter will also assess Beijing's attempts to use foreign participation as a driving force for the elimination of the 'command economy mentality' and the creation of professional management and corporate governance together with a modern credit culture throughout the banking system. Nevertheless, foreign banks were given a very cautious welcome onshore, as was plain from the central bank's summary of their market access on the eve of the global crisis.

[Since China's WTO accession in 2001] ... foreign banks are allowed to provide RMB services to Chinese companies in 25 cities ... Under the precondition of ensuring the state's controlling stake and the country's financial safety, foreign capital were allowed to take part in the reform of state-owned commercial banks.⁵⁰

Chapter 3 investigates the marked contrast between the major role played by foreign manufacturers in China and the stringent restrictions imposed on foreign banks.

Cultural converts

For many governments anxious to exploit market forces to reform their economies, financial institutions have proved the most difficult to liberalise. Former Soviet states in Eastern Europe, as well as Latin American nations, found that privatisation and foreign take-overs offered no guarantees of efficiency, let alone profitability.⁵¹ China chose a reform strategy which has been hailed as 'as unique among emerging markets', yet its basic principle was the same as elsewhere in the world: modern financial markets must be open and competitive. Beijing's approach to implementation, however, was very different.⁵² The government would turn its four largest banks into free-standing business corporations, accountable to their shareholders and listed on international stock exchanges. This 'transactional model', recent research has concluded, 'facilitated inter-organizational learning that has translated into tangible results'. Its merits have been endorsed by its imitation by sovereign wealth funds from Singapore, and the Middle East in deals with Western banks since 2007.

China's strategy of using entry into global markets as a shortcut to modernisation required its banks and their regulators to adapt to international practices and procedures. They were already familiar with the distinct Anglo-American model of corporate governance, and they were aware of how, since the mid-1990s, there had been 'a trend of convergence' overseas.⁵³ As the global crisis intensified in 2007, China's financial officials displayed a close knowledge of American and British regulators and their dilemmas. The People's Bank Governor expressed a degree of kinship with these overseas counterparts. He cited examples, for instance, of corporate scandals in China which matched the American Enron and WorldCom collapses both in their fraudulent strategies and in their timing. Zhou also drew directly on China's recent history to identify the key issues which Western regulators would have to tackle. There was even matching rhetoric: his observations at this early stage of the global crisis were to be paralleled in following months by the comments of American and British central bankers and regulators.

Like American and British financial officials, the Governor was an ardent advocate of moral hazard and unenthusiastic about rescuing banks in trouble: they ought to pay the penalty for their business blunders as a warning to the rest of the industry. But he understood as well as Washington and London that central bankers could not stand idly by as the banking system crumbled, and he was vigorous in defending the Governor of the Bank of England for reversing an earlier decision not to bail out Northern Rock Bank. His views were almost indistinguishable from American and British central bankers on the need to avoid 'over-reacting' to the crisis with measures that would stifle future growth of financial services. He rejected the backlash against 'securitized products and other derivatives' from those arguing that 'simpler is better'. He insisted that the fault was not in the technical sophistication of the products but arose from 'problems in information disclosure or the pricing mechanisms'.⁵⁴ Significantly, too, the China Banking Regulatory Commission published an assessment of the global financial crisis and its causes which had a great deal in common with the post-mortems conducted by its counterparts in Washington and London.⁵⁵

The invisible hand

Throughout the three decades of sustained growth which started in the 1978, China, in common with other Third World nations, had intended to reform the regulation of its financial system 'in line with prevailing intellectual fashions and following the example of industrial countries'. It shared the same enthusiasm for dismantling administrative controls and fell into the same error of neglecting the regulatory and other

institutional systems needed to maintain financial stability.⁵⁶ Chapter 3 will demonstrate how reform without regulation was hazardous, all the more so because of the nation's complex political arrangements and the Chinese Communist Party's dominant status. Despite 30 years of economic reform and sustained breakneck growth, market forces had still not taken command of China's economy. 'While the state sector of the economy has shrunk significantly (to approximately 30 percent of the national economy)', Professor David Shambaugh, a distinguished China specialist, has observed, 'This is deceiving as the state remains the "invisible hand" dominating the economy'. It maintains this control, he explained in an article published in an official newspaper, 'through state banks, state assets, state ownership, state manipulated prices, state cadres, and unpredictable state intervention in various economic sectors'.⁵⁷ China's financial regulators can never escape from this 'invisible hand', which reduces their capacity to perform effectively. Especially damaging have been the losses which the banks were forced to incur because 'policy' and 'relationship' lending remained rife. The banks have been compelled to provide credit to enterprises in obedience to state directives regardless of the borrowers' creditworthiness, the People's Bank has complained. Similarly, a banker's decision to provide credit facilities often depended less on the borrower's ability to service the loan and far more on the relationship with the applicant, which might be personal, Party-related or corrupt.⁵⁸

As a result, China offers considerable evidence that financial liberalisation without professional and independent regulators is a prescription for financial instability. For the most part, China's leaders have accepted that central bankers and regulators need autonomy as well as technical expertise to do their job, but the Party has felt free to revive the 'command economy mindset' whenever it is politically expedient to do so.⁵⁹ Chapter 4 consists of four case studies that illustrate this state of affairs. The first reviews China's experiences during the 1997–98 Asian financial crisis, which became the catalyst for moves towards regulatory autonomy. The analysis examines why the attempts to reform and recapitalise the banking system were only partially successful. The second and third deal with the costly consequences of the government's desperate measures in 2008–09 to finance its US\$586 billion economic stimulus package to counter the international financial crisis. What made the situation all the more alarming for China's leaders was that the nation's economic performance had begun to deteriorate even before world demand for China's exports started to fall in the wake of the global downturn.⁶⁰ The rules of fiscal and banking prudence were set aside; the banking reforms of the past decade were seriously weakened in consequence; and a property bubble developed. The final case study discusses

Beijing's limited use of Hong Kong as a force for the modernisation of its major banks and its corporate practices.

Hong Kong, where regulation triumphed

Hong Kong has made a unique but often undervalued contribution to China's modernisation. At the end of the first two decades of its 'open door' policies, a national leader sought to put the record straight.

Over half of China's exports and imports have either gone through or come from Hong Kong [since 1978], and so it is with the capital influx ... Without Hong Kong, the Chinese mainland could not have accessed the global market and sent its commodities to every corner of the world as smoothly as it has for the past 20 years.⁶¹

Those achievements would have been impossible if Hong Kong had not possessed a financial system capable of meeting all demands on it, both from Mainland manufacturers and exporters and from international investors and trading partners.⁶² Hong Kong has remained pre-eminent in this role, unmatched by any other city in China. After three decades of financial as well as economic reforms, it was home to the only part of the nation's banking system that operated an efficient and fully competitive market, according to a 2009 IMF report.⁶³

In theory, Hong Kong and the ability of its bankers to meet China's needs, were supposed to be a model for the nation to imitate.⁶⁴ During the 1980s, Mainland areas scheduled for priority development were frequently encouraged to 'draw on Hong Kong's experience' in seeking, among others goals, greater access to overseas capital.⁶⁵ In the next decade, nevertheless, one of China's state-owned banks in Hong Kong lamented the continuing problems with the government's disruptive intervention in the Mainland's financial sector.

Throughout the reform process China was unable to escape from the vicious circle of "decontrol results in chaos, chaos leads to recontrol, and control is followed by stagnation". The decontrol and recontrol circle keeps returning.⁶⁶

Despite increasingly close working relations between the Mainland's banking institutions in Hong Kong and the rest of the industry, considerable ingenuity was required to devise arrangements that would overcome the nervousness of Mainland officials when authorising Hong Kong borrowings.⁶⁷ Nevertheless, Hong Kong propelled southern China into industrial take-off and financed Guangdong province's transformation into China's leading centre of manufacturing growth and foreign trade, a development that considerably exceeded expectations on the Mainland side and was completely unplanned on Hong Kong's part.⁶⁸

A surprising feature of China's efforts to modernise its banking system is how limited has been the use made of Hong Kong as a model in the present century. Shortly before the global crisis, Joseph Yam, Hong Kong's senior central banker, publicly questioned whether the Mainland and Hong Kong 'have a working relationship that maximises the mutual benefits of the two jurisdictions and therefore is in the best interests of the country'. Yet, this experienced official could rightly boast that, despite Hong Kong having a mere 0.5 per cent of China's population and a GDP equivalent to only 8 per cent of the Mainland total, its banking assets equalled 21 per cent of the Mainland figure. Furthermore, its financial system was 'more open, developed, competitive and efficient, by virtue of its long history of market freedom'.⁶⁹

There are clear parallels between the minimalist regulatory environment and its market abuses which led to regular cycles of bank runs and financial panics in Hong Kong before 1986 and the origins of the global crisis of 2007–09.⁷⁰ Chapter 5 will discuss Hong Kong in its global context and how it came to discard the fundamental concepts of the Anglo-American consensus and, instead, made financial stability an overriding priority in its official policies. The chapter's most striking conclusion is that strict regulation — including quantitative restrictions abandoned almost everywhere else — did not handicap the financial sector's growth, its creative dynamic or competitive forces. Nor has government intervention encouraged financial institutions to behave recklessly. Chapter 5 investigates allegations that regulatory activism weakened the *laissez-faire* foundations of Hong Kong's prosperity and argues that pragmatism has counted for more than economic ideology in its economic success.⁷¹ Its rejection of the Anglo-American approach, it will be asserted, ensured that Hong Kong financial system emerged intact from the severe strains generated by the Asian and the global financial crises.⁷²

Cultural considerations

Financial policy-makers 'make no explicit concessions to culture', an insightful study of this issue has noted, yet 'cultural factors underlie economic and financial structures to a greater extent than is often realized'.⁷³ Throughout this book, 'culture' is used as shorthand for a shared outlook or set of attitudes. It is a term of convenience that avoids the baggage that might come with references to the 'political' or 'ideological'. Ideally, quotation marks should be employed to warn that the word is not used in a precise, technical sense, but it appears too frequently for this safeguard to be practical.

'Regulatory culture' is intended to convey the values and attitudes which financial officials share in common across national frontiers and

which shape their policies and their practices. It validates for them the preconceptions which they look upon as their principles, both in making policy and in taking action. Culture here includes a pattern of behaviour which is regarded as 'good' in the sense that the officials concerned believe the general public will deem their actions to be both acceptable and appropriate. Although this culture is largely an Anglo-American creation, it is independent of the very significant differences in the two nations' ideology, political institutions, legal systems, public expectations and popular prejudices, as chapters 1 and 2 will indicate.⁷⁴

The Anglo-American culture and the broad intellectual consensus that sustains it are sometimes confused with the 1990 'Washington consensus', which proposed a blueprint for liberalisation in emerging and Third World economies in that decade (although it was less relevant to Asia).⁷⁵ American and British officials did not set out to invent regulatory standards for the world's banks. The formal proposals they developed (mainly through the Basel Committee process) were 'initially designed for internationally active banks'.⁷⁶ The Anglo-American culture thus preceded the 'Washington consensus' and survived its eventual fall from favour.⁷⁷

For Chinese financial institutions, reform has been described as a cultural process which involves 'the reshaping of sustained collective expectations of key actors in charge of decision-making inside banks, and also of regulators and other policy-makers from the outside'.⁷⁸ Since 1978, China's success in generating huge trade surpluses and attracting vast influxes of foreign investment locked it into the global markets whose supervision has been dominated by the Anglo-American culture.⁷⁹ Chinese officials themselves show a desire to achieve a cultural transition and refer, for example, to the unfortunate legacy of the 'command economy mentality' and to the need to create a new 'credit culture'.⁸⁰

The convergence between attitudes in Beijing and in Washington and London has already been noted. Initially, the prospects for such a meeting of minds had seemed poor. The Anglo-American culture faced serious opposition in East Asia, Professor Meredith Woo has argued, where politicians were 'outcome-oriented' and believed economic controls were the best guarantee of achieving their goals. Although 'it is still the case that [China] does not provide a legal environment similar to that in Europe or the United States', this well-known Asian development specialist stated, the Anglo-American regulatory culture has won a place in China's modernisation. China was the most 'anti-market' of all Asian states until 1978 when it started to dismantle the legal, planning and financial structures imported from the former Soviet Union. Wholesale borrowing of American legal models from early in the reform era laid the foundations for the Anglo-American culture to become a potent and very visible influence.⁸¹

Hong Kong's liberal and capitalist cultural characteristics have been enshrined constitutionally in China's Basic Law as the basis for its political, economic and social systems until 2047 but are expressed in pragmatic terms, such as a commitment to free and open markets, fiscal conservatism, non-interventionism and the rule of law. Nevertheless, while its international financial centre has long been a close partner of New York and London, Hong Kong is not a disciple of the Anglo-American regulatory culture.

Regulators in their own words

This book's concern is with regulatory policies, their origins, aims and implementation. The objective is not to provide an analysis of the monetary or economic causes of the global crisis or an account of how financial markets embarked on increasingly self-destructive behaviour. These matters have been dealt with for the United States in 400 pages of lucid detail by the Financial Crisis Inquiry Commission's *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*.⁸² The aim here is to explore the connections between the regulatory culture and regulatory performance. The focus is on delineating the main preconceptions and policy constraints which can be shown to have shaped policy and enforcement. Throughout the text, 'regulation' is used to refer to all forms of government oversight and control of financial markets and institutions, without distinguishing the term from prudential supervision. (A blurring of this distinction reflects usage common among American and British officials themselves.) 'Financial officials' is used to refer to those who carry out such duties without distinguishing between, for example, central bankers and financial regulators.⁸³

In seeking to identify the principal features of the dominant Anglo-American culture and their relevance to the global crisis, the analysis relies, almost exclusively, on the public accounts of their stewardship offered by senior American and British monetary officials themselves. It may be objected that this public record must be misleading because it does not cover the internal political, commercial and personal pressures that were involved in the relationships between financial officials and the governments they served. On the other hand, these officials enjoyed considerable autonomy in Washington and London, and the prevailing regulatory culture had won support across the political spectrum. Central bankers and financial regulators were engaged in a constant and extensive dialogue with the financial services industry, the wider business community and opinion makers. They also had to account for themselves in considerable detail before congressional and parliamentary

forums.⁸⁴ This public record, which embraces discussions of considerable technical sophistication as well as more ‘political’ presentations, allows the financial officials’ outlooks, priorities and responses to events to be examined in considerable detail, both during the global crisis and in the preceding decade. Thus, while reliance on the official record carries a risk of self-censorship or self-serving presentations by leading officials, the chapters that follow will show how, in fact, these officials have revealed with considerable frankness the regulatory failings which created the business environment that led to the global crisis.⁸⁵

As far as possible, the same approach has been adopted in studying China’s regulators. For the earlier part of the post-1978 reform era, the discussion relies, almost exclusively, on the information, comment and data published in the official Chinese media. Once China became a major participant in global markets, its financial officials had to establish a dialogue with the world at large.⁸⁶ Thus, analysis of events since 1998 has the benefit of material published by China’s central bank and regulatory agencies themselves. Wherever possible, this book uses the version of such material (and of articles in the official media for this later period) intended for international consumption. Public and political debate is neither free nor open in China, and the media face severe constraints on the right to investigate and report. Chapters 3 and 4 will demonstrate how detailed, nevertheless, was the information made public about the nation’s financial problems even before the death of Mao Zedong in 1976 and the rise of the reformers.

In addition, ample use has been made of the advice, analysis and research published by international ‘supervisory’ agencies: the International Monetary Fund (IMF) especially but also the Bank for International Settlements (BIS), the Organisation for Economic Co-operation and Development (OECD) and the World Bank. These reports rely very largely on national central bankers and regulators with whom these international agencies’ staff have been engaged in dialogue.

Conclusions — Resisting Reforms

The international financial crisis of 2007–09 was arguably the worst ‘in the two hundred year history of the modern capitalist system’.¹ A truly global phenomenon, it ‘unfolded in an environment where financial institutions and other investors were excessively optimistic about asset prices and risk’, the IMF has reported. ‘Overall banking system leverage’ was most alarming in the United Kingdom, the United States, Germany and Switzerland, but similar trends were observable in China (and India and Brazil as well), though to a much lesser degree.² The consequences for the real economy were dire: ‘Banking contributed to a Great Recession on a scale last seen at the time of the Great Depression’.³

When growth comes first

Those in charge of the world’s largest financial markets had gone for growth almost regardless of cost — a choice that met little opposition — and so were lulled into three miscalculations which account for much of the financial disaster that has occurred since 2007.

The history trap

The banking industry has a marked propensity to forget the unpleasant experiences of the past, and so have financial policy-makers.⁴ Regulatory safeguards come to be regarded as relics of an earlier age, irrelevant to the mature markets of the present.⁵ The danger is that during periods when earnings are buoyant and managements regularly exceed profit expectations, risk is seen as the real recipe for maximizing investors’ returns. Thus, for example, ‘LBOs, leveraged restructurings, takeovers, and venture capital firms’ were lauded as a source of corporate salvation in the 1990s.⁶ Chapter 2 and its case studies illustrated how the Anglo-American culture made officials reluctant to intervene even when confronted with evidence that financial stability was in danger. ‘But human

nature being what it is', banks cannot be left to their own devices, a 2009 OECD report argued. Easing of regulatory restraints on financial institutions was to have catastrophic consequences for their stability in 2007–09, the OECD researchers commented, when Citibank and Deutsche Bank, for example, came to 'look much more like large highly leveraged hedge funds'.⁷

The reform trap

In the 1980s, 'developing country governments began to modernize and liberalize their regulatory systems in line with prevailing intellectual fashions and following the example of industrial countries', a well-known study observed. They set about dismantling administrative controls with enthusiasm but overlooked the need to put in place the regulatory and other institutional systems needed to maintain financial stability, it continued. The assumption was that market forces would achieve their own balance, through efficient management of lending especially.

The new banking entrepreneurs and their inexperienced regulators were thus left 'to feel their way to an assessment of what safe and sound banking would mean in practice'. All too often, liberalisation uncovered 'a long-standing underlying insolvency of the banking system', which became unavoidably clear as banks emerged from 'the sheltered environment that allowed or required them to cross-subsidize loss-making lines of business'.⁸ Reform without regulation proved hazardous. Chapters 3 and 4 showed this miscalculation at work in contemporary China (as had been the case during Hong Kong's earlier development). This 'trap' is, of course, a very general experience of the emerging and Third World economies.

The growth trap

The general assumption that rapid growth worldwide would be more than enough to offset the costs of financial crises was always open to question. Among the research evidence available to guide policy-makers before 2007 was an impressive survey which calculated total damage suffered during crises in the closing decades of the 20th century. On average the losses were equivalent to 33 per cent of GDP, a far from trivial figure.⁹ Supporters of the Anglo-American consensus were not daunted by estimates of this order, however, and believed the economic arithmetic favoured giving priority to growth. 'Although crises are costly and have severe recessionary effects, they are rare events', one large-scale study concluded, 'Over the long run, the pro-growth effects of greater financial deepening and more investment by far outweigh the

detrimental growth effects of financial fragility and a greater incidence of crises'.¹⁰ Thus was the 'growth trap' set, and regulation seemed redundant when reforms allowed markets the freedom to find optimal solutions which, it was believed, would be superior to financial officials' initiatives.

No alternative

The bias in favour of growth at all costs is likely to persist despite the risks of instability that may be involved. Impressive historical statistics have created a presumption in favour of the Anglo-American regulatory culture and its insistence that the right of financial services to generate profits should be constrained as little as possible even after the global crash. The estimate for the United Kingdom is that 'growth in financial sector value added has been more than double that of the economy as a whole' for 160 years. For the United States the estimated value added by the financial sector has risen 'from about 2% of total GDP in the 1950s to about 8%' by 2010.¹¹ It is fair to ask what could replace growth dynamic of this order.

The best of intentions

This book has argued that officials rather than their political masters made the fatal decisions. Central bankers and financial regulators everywhere are subject to political controls because in the last resort they can be removed if they lose the government's confidence. Yet, more and more political leaders have discovered how they can benefit from allowing these officials considerable autonomy. The issues for which they are responsible are almost always technical, esoteric and difficult to explain to the media and the public at large. Worse still, 'when your action means higher mortgage payments and higher costs of doing business', one central banker has pointed out, 'It is awfully difficult to say convincingly that this is all for the good of the community in the long run'.¹² Elected politicians have much to gain from allowing officials to take responsibility for painful financial and monetary decisions. Over recent decades, these officials in Washington and London have come to enjoy bipartisan support and won considerable freedom from political interference, arrangements which have survived the global financial crisis and the bitter political campaigning during an American presidential and a British general election together with the change in ruling parties that followed.

Andrew Sheng, one of Asia's most distinguished regulatory officials, has asked how the global financial crisis could happen 'since Western

regulators all had increased resources, perceived independence of action and technical tools all in place'. He conjectures that regulators had become 'captive to lobbying power of the financial industry'. He quotes the research findings on the tendency for regulators to be 'captured' by the industries they are supposed to be overseeing.¹³ By contrast with the attacks on cronyism's contribution to the 1997–98 Asian financial crisis, he suggests, there has been 'a deafening silence' on the links between regulators and business as a factor in the global collapse of 2007–09.¹⁴

This issue has been addressed directly in the case of Ireland, one of the worst-hit European economies where allegations of cronyism have been widespread. Regulators' deference to business and political leaders was investigated in a trenchant official review under the direction of Professor Patrick Honohan of why Irish banking fared so badly in the global crash. This report concluded that, at the very most, officials 'might have instinctively and almost unconsciously shied away from aggressive action' against the well-connected. The available evidence indicated, however, that regulators needed no persuasion to overlook improper and imprudent banking behaviour; still less did they need to be bribed. Officials believed that they could trust bankers to know their own business best and that the lightest touch regulation was in the national interest.¹⁵

As for the leading American and British central bankers and regulatory officials, what with hindsight can now be seen to have been disastrous mistakes started with a political and academic consensus widely shared before 2007 and subject to only limited revision since. The analysis presented in this book has recorded how the most glaring misjudgments were made in public with clear explanations of the official reasoning behind the decisions. This left a paper trail which chapter 2 followed and which does not support the suggestion that the regulators in Washington and London had changed roles and become the 'clients' or 'captives' of financial institutions. The officials involved were victims of the prevailing culture which made them defeatist about the effectiveness of regulation and naive about the behaviour of market participants. Thus, for example, in the negotiations over Basel II, officials can be accused of accepting proposals from the industry on how to calculate capital requirements which were so complex as to be daunting to supervise effectively.¹⁶ In the case of the Bank of England, this prospect was openly defended as unavoidable on the grounds that 'any set of accounts, however drawn up, is likely to be considerably deficient ... in terms of outlining the economic realities of risks within the balance sheet'.¹⁷

No less relevant were the mistaken 'good intentions' of policy-makers generally. In Washington the Securities and Exchange Commission

has described the origins of the sub-prime mortgage debacle as the desire to fulfil the American dream of a nation of home owners. Its unintended consequences were the discarding of due diligence in processing applications for housing loans and a dangerous disregard for surging mortgage defaults.¹⁸ In China similarly unimpeachable intentions inspired the economic stimulus package of 2008 and seemed to justify every measure possible to avoid a recession, chapter 3 explained. The unintended consequences here included a surge in non-performing loans as previous prudent policies were discarded and the law itself ignored.

Resisting reforms

Most damaging of all was a combination of ignorance and complacency. The British have admitted that ‘the real failure was a lapse into hubris’.

... we came to believe that crises created by massive maturity transformation were problems that no longer applied to modern banking ... There was an inability to see through the veil of modern finance to the fact that the balance sheets of too many banks were an accident waiting to happen, with levels of leverage on a scale that could not resist even the slightest tremor to confidence about the uncertain value of bank assets.¹⁹

American officials regard the principal source of this unawareness as ‘the shadow banking system’ whose activities ‘were not subject by law to strong consolidated supervision by federal regulators’.

... neither the investors, nor the rating agencies, nor the regulators, nor even the firms that designed the securities fully appreciated the risks that those securities entailed ... These risks grew rapidly in the period before the crisis, in part because the regulators — like most financial firms and investors — did not fully understand or appreciate them.²⁰

Despite these confessions and the powerful case they made for reforms, changes were slow in coming. One IMF report pointed out, for example, that ‘an institution can never have enough capital or liquidity if there are material flaws in its risk management practices’. It warned too that little serious attention was being given in 2010 to such basic precautions as ‘oversight: supervision, governance, and market discipline’.²¹ Regulation was perceived to be in conflict with growth, and enthusiasm for reforms after the global crisis was constrained by fears that they would slow down overall growth and reduce profit opportunities. An IMF review of ‘regulatory reforms that were emerging in policy discussions’ found that their focus was on ‘lowering risks, raising costs,

and thus, most likely, lowering returns' earned by the financial sector. If implemented, banks would be smaller and offer fewer, simpler and cheaper products although these would be more effective in meeting their customers' needs. The new financial system would probably 'look less innovative and dynamic and more old-fashioned'. Such downsizing and simplicity were hardly a vision of the future likely to win enthusiastic endorsement from the financial industry itself. At the same time, this IMF study warned, governments were likely to find that a more stable and more regulated system would be associated with slower growth for the entire economy.²² This prospect was not a great encouragement for policy makers and politicians to embrace the proposals.

The crisis had shown that 'central bankers knew less than what they thought they did', the IMF has commented.²³ This lesson was particularly striking when it came to reliance on the markets as reliable guides to corporate quality. For example, those banks whose share prices had made them the market favourites in 2006 suffered the worst in 2007–08, according to one large-scale study.

... the attributes that the market valued in 2006, for instance, a successful securitization line of business, exposed banks to risks that led them to perform poorly when the crisis hit. The market did not expect these attributes to be a source of weakness for banks and did not expect the banks with these attributes to perform poorly as of 2006 ... banks were differentially exposed to various risks by the end of 2006. Some exposures that were rewarded by the markets in 2006 turned out to be unexpectedly costly for banks the following two years.²⁴

Thus, "old" certainties about the "new" financial landscape, shaped by lightly regulated entities and financial innovations that would allow them to "efficiently" allocate risks are waning and many of them are being dethroned', an OECD report optimistically asserted. Nevertheless, there was no great appetite for reversing deregulation. Mistrust of state involvement in economic management persisted, the OECD's comments made plain, and the importance of letting markets decide which institutions should fail remained an article of faith.²⁵

Hostility towards government intervention intensified as memories of the first traumatic shocks of the global crisis receded. Demands for the authorities to repudiate all commitment to rescue financial institutions and even financial markets became insistent, and the dangers of moral hazard were frequently invoked. As chapter 1 noted, criticisms of state intervention were frequently misconceived or misleading and based on Anglo-American articles of faith. A remarkable example of such dogmatism was the assertion by an official inquiry into the 2008 Citigroup bailout that avoidance of moral hazard should have taken

priority over the stability of United States' financial markets and the well-being of the global economy. The inquiry's report admitted in 2011 that the government's US\$45 billion capital injection (plus a much larger guarantee) had 'not only achieved the primary goal of restoring market confidence in Citigroup, but also carefully controlled the overall risk of Government loss on the asset guarantee'. 'Citigroup did not fail, and the global economy avoided the catastrophic financial collapse that many feared would flow from a Citigroup failure', it added. Indeed, the report acknowledged, 'the Government incurred no losses, and even profited on its overall investment in Citigroup by more than \$12 billion'. These impressive achievements were deemed insufficient to justify this rescue operation. The government had created a category of institution 'too big, too interconnected, and too essential to the global financial system to be allowed to fail', the report baldly asserted, and Citigroup's bailout 'undoubtedly contributed to the increased moral hazard that has been a direct byproduct of TARP'.

No factual evidence of TARP's corrupting effect on the conduct of banking business was produced to support the report's verdict: 'By standing behind Citigroup, [the government] did more than reassure troubled markets — it encouraged high-risk behavior by insulating the risk takers from the consequences of failure'.²⁶ Totally ignored was the acumen with which Federal Reserve officials had mounted an investment operation that would have won market acclaim if the deal had been put together by a commercial banker. Instead, they were pilloried, just as their Hong Kong counterparts had been in 1998 — ironically by the Federal Reserve Board itself — for a similar feat in calling the market so accurately (as the previous chapter recounted).

Fidelity to the central tenets of the Anglo-American culture was encouraged by a realisation that paradoxically, the world's financial system had proved far more stable than could have been prudently forecast in 2007–08. Financial markets may have seriously misgauged both risk and profit prospects before 2007, but they neither closed down nor descended into chaos. However traumatic for the real economy and society at large, the financial crisis itself seemed to become increasingly not only manageable but affordable as well. The robustness of the financial markets themselves and the resilience of financial corporations — albeit with government bailouts — meant that the heaviest losses would be borne by the rest of the business community and by the general public. Despite the political resentment that this state of affairs caused, once the immediate panic had abated, the pressure for rapid and radical reforms eased and progress slowed. For example, it was agreed that implementation of international initiatives included in Basel III would

take place over a lengthy period,²⁷ and there was no great rush by the United Kingdom to implement its domestic reform package.²⁸

Affordability was an unexpected outcome. The state outlay on rescuing the American and British banking systems was equivalent to around 1 per cent of GDP, the Bank of England calculated, and ‘recouping these costs from banks would not place an unbearable strain on their finances’.²⁹ This resilience was not the result of any innate robustness but the outcome of state rescue packages which have proved less ruinous than had been predicted when the bailouts began. For example, in the United States, ‘as voters rage and candidates put up ads against government bailouts, the reviled mother of them all — the \$700 billion TARP [Troubled Asset Relief Program] lifeline to banks, insurance and auto companies could conceivably earn taxpayers a profit’, it was being forecast in late 2010.³⁰ Such statistics help to clarify the background to government discussions on what regulatory reforms might reduce the risk of future global crises. They could be read as evidence that government intervention could resolve the most severe financial emergencies and that if disaster were to strike again, state rescue measures would be affordable and effective. On this analysis, there was no need for urgent changes to overhaul the system.

Manageability also came as a surprise. What proved the key factor in 2007–08 was institutional size, when a limited number of very large banks were found to be the most serious threat to financial stability and government rescue programmes had been able to ignore the woes of most smaller banks. Worldwide, ‘90 per cent of the support offered by governments during the course of the crisis’ went to 145 banks which accounted for ‘85 per cent of the assets of the world’s top 1,000 banks’. Their average assets were in excess of US\$100 billion, and their failure would have been catastrophic.³¹ Thus the chief priority in crisis management was believed to have shifted from the banking industry as a whole to a small group of dominant players on whom central bankers and financial regulators could concentrate their attention.

Too big to fail

The chief concerns for American and British officials after the crisis were system and size. In theory the Anglo-American regulatory culture had recognised that ‘supervision (looking at the individual institutions and markets) and the systemic factors involving concentrations, inter-relationships and behaviour in relation to the system as a whole’ must both be regarded as ‘an essential element in the provision of financial stability oversight’.³² But the two were not of equal weight in the post-2007 political climate, and systemic risk was regarded as the more urgent

priority. The Chairman of the Federal Reserve Board insisted during a 2009 discussion of regulatory reforms that ‘strong and effective regulation and supervision of banking institutions’ were not enough to reduce system risk. What was required, he argued, were much vaguer goals: ‘reforms to the financial architecture, broadly conceived’ and regulation of ‘the financial system as a whole, in a holistic way, not just its individual components’.³³ This retreat into imprecision was understandable. As a British parliamentary report had noted a little earlier: ‘There is no consensus about what financial stability means, how it should be measured and how the balance should be struck between the pursuit of a financial stability objective and other public policy objectives’.³⁴

Moral hazard was a different issue, however, on which the Anglo-American consensus had unambiguous views, the most important of which was the need to ensure that this principle was incorporated into policy initiatives to deal with systemic risk and banks ‘too large to fail’. In 2006 the Bank of England had explained why banks must be allowed to fail.

... the authorities cannot and should not be expected to intervene with a support package every time a bank — even a large one — gets into difficulties. The cost of such an interventionist approach, in terms of market discipline and fiscal burden, would be substantial. And it would in all likelihood compromise the efficient provision of financial services and inhibit the exit of weak firms from the industry.³⁵

As the crisis in the United Kingdom intensified in 2008, the Bank continued to fight strenuously for the right to allow banks to go out of business ‘to encourage prudent behaviour by others’.³⁶ There was wide political support for this stand. A parliamentary investigation into the collapse of British financial institutions described banks as ‘special’ organisations, ‘similar in some ways to utility providers’. Nevertheless, its report stated, ‘banks should be allowed to “fail” so as to preserve market discipline on financial institutions’. It was essential, the report added, ‘to ensure that [the] framework for maintaining financial stability does not provide free insurance to banks’ or a guarantee that no bank would be allowed to fail.³⁷ Moral hazard remained the regulators’ gold standard.

Washington took an almost identical view. As President George Bush’s administration was coming to an end in 2008, officials expressed apprehension that ‘events have called it into question’ the benefits generated by free and competitive markets. The public, therefore, should be left in no doubt that the massive rescue operations launched by the government were only temporary measures, and ‘there has to be a deliberate design to eliminate them’.³⁸ This commitment to the market did

not alter as President Barack Obama took office. The concept of moral hazard was sacred, and the right to let financial institutions fail was presented as non-negotiable. In 2009 the Chairman of the Federal Reserve Board used virtually the same wording as he had done in 2005 to reject any obligation to save even the largest banks. Even after the Lehman catastrophe, he remained determined to dispel the notion that the government would automatically 'prevent the failure of a large, highly interconnected financial firm' despite the disruption that the financial system and the broader economy might suffer in consequence. The price to be paid for classifying some firms as 'too big to fail' would be dire, he insisted.

... it reduces market discipline and encourages excessive risk-taking by the firm. It also provides an artificial incentive for firms to grow, in order to be perceived as too big to fail. And it creates an unlevel playing field with smaller firms, which may not be regarded as having implicit government support. Moreover, government rescues of too-big-to-fail firms can be costly to taxpayers, as we have seen recently. Indeed, in the present crisis, the too-big-to-fail issue has emerged as an enormous problem.³⁹

Discussion of this issue was often one-sided and ill-informed.⁴⁰ As Lord Turner, a leading British regulator, was at pains to point out, history demonstrates how 'multiple small banks can fail as much as large and with as harmful effects'.⁴¹ During the global crisis, the fragility of banks was not the result of their size, he insisted.

The really big economic costs of the most recent crisis are not the explicit costs of big bank rescue, but the economic volatility resulting from the credit/asset price cycle, and such volatility could be generated from the competitive interaction of multiple medium size banks as much as from the actions of Too-Big-To-Fail banks.⁴²

Replacement of the biggest financial institutions by a large number of small players would not lead to a more stable or more efficient financial system, according to an IMF study. 'The whole network, which is what matters for macroeconomic and financial stability, would probably be more, not less complex', the report continued, 'since it would take many linkages to perform some of the transactions that are internalized within and through larger institutions'. While 'each individual small bank would be simpler', the assumption that 'if these linkages instead were implemented by thousands of small institutions they would be much less complex and more transparent' is misleading.⁴³

The Anglo-American focus on systemic risk and the moral hazard caused by the largest financial institutions involved more than managing the priorities for changes in regulatory policies and protocols. It was

linked to the explanation being developed to account for the failure of American and British officials to respond to the growing vulnerability of their financial markets ahead of the 2007 crash. Among the most enduring doctrines propounded by Alan Greenspan, former Chairman of the Federal Reserve Board, was the assertion that officials could not be expected to have sufficient comprehension of financial markets to oversee them effectively, as the ‘Introduction’ explained. Before 2007, therefore, it would have been fruitless to try to adjust regulatory arrangements to changing market conditions. In the aftermath of the global financial crisis, central bankers and financial regulators have used this Greenspan doctrine to explain why they were taken unawares by the events of 2007. The principal threat to financial stability had become the leverage exerted by the very large, multinational firm which had multiple financial businesses operating in several regulatory and legal jurisdictions, they have averred.⁴⁴ The dangers of systemic risk and institutions ‘too big to fail’ had arisen unperceived, these officials have argued, camouflaged by the astonishing growth in the volume of the world’s financial services and the complexity of its products since the 1970s.⁴⁵

This argument allowed officials to shift blame on to the banking industry itself as they suggested that the largest financial institutions had powerful incentives to disregard the true risks involved in their business models. ‘Everyone knows’ that the biggest banks cannot be allowed to fail, the Bank of England stated. The result, it claims, is that ‘highly risky banking institutions enjoy implicit public sector support ... [which] incentivises banks to take on yet more risk, knowing that, if things go well, they will reap the rewards while the public sector will foot the bill if things go wrong’.⁴⁶ American regulators claimed that not only were the biggest banks given privileged immunity from regulatory oversight, ‘expectations of government support’ meant that they ignored ‘potential losses from risky behavior’.⁴⁷ This analysis is far from convincing. Neither American nor British officials have produced any evidence that financial institutions themselves were any better informed about the rapidly increasing vulnerability of their markets in the run-up to 2007 than investors or regulators. Systemic risk and institutions ‘too big to fail’ are challenges that arose after the market collapse in 2007. They were not its cause. As a United States Treasury official observed in 2009: ‘This crisis has also clearly demonstrated that risks to the system can emerge from all corners of the financial markets and from any of our financial institutions’.⁴⁸

Cultural convergence

Washington and London developed the regulatory strategy which did more to promote global prosperity than any rival approach. Furthermore, the damage done to advanced economies as a group by the disasters of 2007–09 was actually lower than in previous crises, the ‘Introduction’ explained. On this basis, the international financial crisis was just another unpleasant but not unexpected incident among the many that had occurred since 1970. But when it came to the United States and the United Kingdom, earlier chapters have shown, the costs of the 2007–09 crisis would not easily be made good by rapid economic recovery and sustained high growth thereafter. On the contrary, budget austerity and increased public borrowing were expected to be protracted. But these burdens on taxpayers and the general public did not generate sufficient political indignation to cause a repudiation of the Anglo-American regulatory culture and its attachment to free markets.

For all its faults, the Anglo-American culture had been an indispensable force in modernising financial markets and creating an international environment in which growth, especially in Asia, was rapid and sustained. China offers particularly important evidence of the survival value of this culture. That nation’s regulators had a clear grasp of the Anglo-American regulatory arrangements and the way they functioned. Chinese financial officials believed that Anglo-American regulatory attitudes — rather than legal and institutional arrangements — determined whether or not the American and British financial markets would be able to withstand the global crisis.⁴⁹ Chinese officials shared the Anglo-American culture’s commitment to market forces, to which they gave the credit for ‘all progress’ made by China’s banking reforms.⁵⁰ Indeed, in the middle of a damning review of Washington’s pre-2007 regulatory failures, the China Banking Regulatory Commission inserted a defence of liberalisation and echoed American warnings that without freedom to innovate, ‘the market will lose its vitality’. But Chinese officials added an important reservation: the danger of being ‘too obsessed with the market’s self-correction function’.⁵¹

Chinese regulators were also in no doubt as to why autonomy mattered, and they presented their own discreet ‘declaration of independence’. They saw themselves as part of a global confraternity with which China’s cooperation was crucial for its own financial stability.⁵² They claimed that the ‘supervisory architecture’ was not what counted most, but the freedom of national regulators to ‘make independent and responsible supervisory decisions’. On this foundation alone would there be sufficient market and investor confidence for ‘the financial sector to boost the real economy’. Furthermore, the China Banking

Regulatory Commission argued, greater independence was a worldwide goal of regulatory reform. Only by following this international trend and being willing to ‘abide by globally shared transaction and supervisory rules’ could China hope to establish its own international financial centre, the Commission warned in 2010.⁵³

Freedom for China’s regulators to enforce the measures required to maintain the integrity and the stability of the financial system was such a radical reform that inevitably it caused concern among political leaders. Experience showed that China at its current level of development could afford the losses incurred by banks through the failure to modernise the banking industry, its corporate governance and its credit culture. Less clear to the leadership especially after the financial crises of 1997–98 and 2007–09 was whether the financial system could survive future international crises if state controls were eliminated. An ‘open door’ policy had always seemed much more perilous — and less necessary — for banking and financial services than it had done for China’s manufacturing industry, this book has recorded.

The Hong Kong alternative

That the China Banking Regulatory Commission was committed to an independent regulatory system was an important endorsement of Hong Kong, whose regulatory autonomy, it can be argued, was essential for it to survive as an international financial centre after 1997 and the end of British rule. The challenge lay in the political management of perceptions. How could the post-colonial administration and its financial officials quickly establish the sort of credibility which American and British central bankers had taken decades to build up to the point ‘that interference in the work of the central bank is seen to be a political liability — you tend to lose rather than gain votes when you interfere’, to quote the Hong Kong Monetary Authority? Its credibility issues were compounded by the limited democracy permitted to Hong Kong: ‘Whether directly or indirectly elected, the politicians have the mandate of the people [but] do not actually have the authority to direct government policies’, the Authority stated. The result was that legislators were always in opposition and never in power, which made a ‘bipartisan’ approach difficult to sustain. In any case, the Hong Kong Monetary Authority could not hope to achieve popularity because ‘in managing monetary and financial systems, doing the right thing often involves inflicting pain on the majority of the people you serve’. Instead it set out to rank ‘among the most transparent’ central banks in the world. Because it could not rely on ‘faith in an esoteric and aloof HKMA being professional and acting in the best interest of Hong Kong’, it had to make itself accountable

to the community at large.⁵⁴ Its constituents' first demand was freedom from the bank runs and financial collapses that had occurred in each decade until the mid-1980s, and laissez faire had been forced to give way to positive regulatory intervention.

The conviction that regulation is the enemy of growth has been challenged in this book by the experiences of Hong Kong. Chapter 5 described how its regulatory arrangements are among the strictest of any financial centre, and have been tightened steadily over the last decade. Yet, its financial system has flourished, its business volumes have grown, and it has continued to attract the world's leading banks. At the very least, Hong Kong's record over the last 30 years indicates that the Anglo-American regulatory culture is not the only formula for either economic freedom or prosperous and stable financial markets.

Notes

The following abbreviations are used in the Notes and Bibliography:

BIS:	Bank for International Settlements
BofE:	Bank of England
CBRC:	China Banking Regulatory Commission
<i>CD:</i>	<i>China Daily</i>
FDIC:	Federal Deposit Insurance Corporation
FRB:	Federal Reserve Board
FSA:	Financial Services Authority
<i>GIS:</i>	<i>Government Information Services</i> (Daily press releases of the Hong Kong government)
<i>HH:</i>	<i>Hong Kong Hansard</i> (Official report of the proceedings of the Hong Kong Legislative Council)
HKMA:	Hong Kong Monetary Authority (and its publication services)
HKRS:	Government files in the Hong Kong Public Records Office
IMF:	International Monetary Fund
NCNA:	New China News Agency
OECD:	Organisation for Economic Co-operation and Development
PBOC:	People's Bank of China
<i>PD:</i>	<i>People's Daily (Renmin Ribao)</i>
SEC:	Securities and Exchange Commission

Introduction

1. This point is made by Professor Ricardo J. Caballero in 'Sudden Financial Arrest', *IMF Economic Review*, Vol. 58, Issue 1 (August 2010), pp. 11–3, 17–9.
2. 'All the more so given some of the burden will fall on Europe, Japan and even, to a much less extent, China,' he added. Zhou Xiaochuan, PBOC Governor, 'Instability and Evolution of the Financial System' (5 December 2007), p. 5.
3. Northern Rock's irrelevance to the global scene was argued by Verena Ross, FSA Director of Strategy and Risk, 'Lessons from the Financial Crisis', speech at the Chatham House Conference on Global Financial Regulation (24 March 2009); Lord Turner, FSA Chairman, 'The financial crisis and the future of financial regulation', The Economist's Inaugural City Lecture (21 January 2009).

4. Andrew G Haldane, BofE Executive Director Financial Stability, 'Rethinking the Financial Network', speech at the Financial Student Association, Amsterdam (28 April 2009), pp. 9, 10.
5. An excellent example of the regulators' astonishment at the crisis is Verena Ross, FSA Director of Strategy and Risk, 'Risk management governance and controls and their importance in banking system and financial sector stability', speech at the Financial Stability Institute and Executives' Meeting of East Asia-Pacific Central Banks (18 November 2008).
6. Lord Turner, FSA Chairman, Annual Public Meeting Speech (23 July 2009).
7. Sir John Gieve, BofE Deputy Governor, 'The City's Growth: The Crest of a Wave or Swimming with the Stream?', Society of Chartered Accountants, London (26 March 2007), p. 9.
8. Sir John Gieve, BofE Deputy Governor, 'Uncertainty, policy and financial markets', speech at the Barbican Centre (24 July 2007), p. 4. Earlier, in making a similar comparison, another British central banker had quoted Alan Greenspan, then FRB Chairman. Sir Andrew Large, BofE Deputy Governor, 'Convergence in Insurance and Banking: Some Financial Stability Issues', speech at the Mandarin Oriental Hotel (12 June 2003), p. 6.
9. The trend was well below the levels which had led to crises in 1987 and 1998, the Bank of England concluded. Sir John Gieve, BofE Deputy Governor, 'Financial System Risks in the UK — Issues and Challenges', speech at the Centre for the Study of Financial Innovation Roundtable (25 July 2006), pp. 6, 8–9.
10. Charles Bean, BofE Deputy Governor, 'Measuring Recession and Recovery: An Economic Perspective', speech at the RSS Statistics User Forum Conference (27 October 2010), p. 5.
11. Christopher Cox, SEC Chairman, Address to the Joint Meeting of the Exchequer Club and Women in Housing and Finance (4 December 2008).
12. IMF, 'IMF Executive Board Concludes 2009 Article IV Consultation with the United Kingdom', *Public Information Notice (PIN) No. 09/84* (16 July 2009).
13. Andrew G. Haldane, BofE Executive Director, 'Small Lessons from a Big Crisis', remarks at the Federal Reserve Bank of Chicago 45th Annual Conference (8 May 2009), pp. 1–2.
14. Mervyn King, BofE Governor, Address to the 2010 Trades Union Congress, Manchester (15 September 2010), p. 7.
15. Adam S. Posen, BofE Monetary Policy Committee External Member, 'The British Recovery in International Comparison', speech at the Society of Business Economists Annual Conference, London (30 June 2010), pp. 2–4.
16. For use of the term in this sense, see Alistair Darling, M.P., Chancellor of the Exchequer, in House of Commons Treasury Committee, *Banking Crisis*, Vol. I. Oral evidence (London: HMSO, HC 144-I, March 2009), pp. 8, 42.
17. In a retrospective on the global crisis, however, the Chairman of the Federal Reserve Board has claimed that 'the first lesson' from the Great Depression was that 'economic prosperity depends on financial stability'. Ben S. Bernanke, FRB Chairman, 'Economic Policy: Lessons from History', speech at the 43rd Annual Alexander Hamilton Awards Dinner, Center for the Study of the Presidency and Congress, Washington, DC (8 April 2010).

18. This conclusion was supported by a study of 60 countries for the period 1980–2002. Romain Ranciere, Aaron Tornell and Frank Westermann, ‘Decomposing the effects of financial liberalization: Crises vs. Growth’, *NBER Working Paper 12806* (December 2006), p. 16.
19. Charles Bean et al., BofE Deputy Governor, ‘Monetary Policy after the Fall’, paper presented at the Federal Reserve Bank of Kansas City Annual Conference (28 August 2010), p. 5.
20. Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Official Government Edition, 21 January 2011), p. 401.
21. Mervyn King, BofE Governor, Speech given at the Civic Centre, Newcastle (25 January 2011), p. 4.
22. This table summarises the data in Luc Laeven and Fabian Valencia, ‘Resolution of Banking Crises: The Good, the Bad, and the Ugly’, *IMF Working Paper WP/10/146* (June 2010), Table 4. ‘Summary of the Cost of Banking Crises over the period 1970–2009’, p. 22.
23. Stijn Claessens, Giovanni Dell’Ariccia, Deniz Igan and Luc Laeven, ‘Lessons and Policy Implications from the Global Financial Crisis’, *IMF Working Paper WP/10/44* (February 2010), pp. 4–11.
24. House of Commons Treasury Committee, *Financial Stability and Transparency Sixth Report of Session 2007–08* (London: HMSO, HC 371, March 2008), p. 9.
25. See Claessens et al., ‘Lessons and Policy Implications from the Global Financial Crisis’, p. 9.
26. Washington provided substantial funding to British financial firms operating in American markets, however. Such assistance accounted for around 45 per cent of the US\$3.3 trillion which the Federal Reserve system made available to support financial institutions during the global crisis. Richard Blackden and Harry Wilson, ‘UK banks borrowed more than £640bn from US Federal Reserve’, *Daily Telegraph*, 2 December 2010.
27. As measured by the US\$2.8 trillion fall in banks’ market capitalisation for 2007–09. Of this total, Eurozone and American banks each accounted for 28 per cent, while another 11 per cent was attributable to British banks. Gert Wehinger, ‘The Turmoil and the Financial Industry: Developments and Policy Responses’, *OECD Financial Trends*, Issue 1 (2009), Table 1. ‘Banks’ market value losses: Change in market value of largest G10 banks’, p. 4.
28. Wim Fonteyne, Wouter Bossu, Luis Cortavarria-Checkley, Alessandro Giustiniani, Alessandro Gullo, Daniel Hardy and Seán Kerr, ‘Crisis Management and Resolution for a European Banking System’, *IMF Working Paper WP/10/70* (March 2010), pp. 7, 13.
29. Edmund L. Andrews, ‘Fed shrugged as subprime crisis spread’, *International Herald Tribune*, 18 December 2007.
30. Lord Turner, FSA Chairman, ‘Priorities for the reform of global regulation — challenging past assumptions’, speech at IOSCO 2009, Tel Aviv (11 June 2009).
31. Claessens et al., ‘Lessons and Policy Implications from the Global Financial Crisis’, p. 17.

32. Ross, 'Lessons from the Financial Crisis'.
33. Laura Kodres and Aditya Narain, 'Redesigning the Contours of the Future Financial System', *IMF Staff Position Note SPN/10/10* (16 August 2010), p. 4. An American official used much the same language. See Sheila C. Bair, FDIC Chairman, Testimony on Regulatory Perspectives on Financial Regulatory Reform Proposals before the House of Representatives Financial Services Committee (24 July 2009).
34. A senior British regulator has disputed the contribution made by the pre-2007 light touch regulatory régime to genuine wealth creation: 'If the [financial services] industry grew dramatically in the decade to 2007 [the Chicago School claims] that must be because it was performing value added services: if complex product innovations were able to sustain themselves economically, they must have been socially useful innovations. But after what has happened, I think we know that that is not the case'. Turner, 'The financial crisis and the future of financial regulation'.
35. He has also been one of the sharpest critics of the regulatory culture. Lord Turner, FSA Chairman, Speech at The Turner Review Conference (27 March 2009).
36. FSA, 'Memorandum from the Financial Services Authority (FSA)', in House of Commons Treasury Committee, *Banking Crisis*, Vol. II. Written evidence (London: HMSO, HC 144-II, March 2009), pp. EV 456–7 especially; Sheila C. Bair, FDIC Chairman, Testimony on Modernizing Bank Supervision and Regulation before the Senate Committee on Banking, Housing and Urban Affairs (19 March 2009).
37. Planning and state controls were a product of another kind of historical experience. World War II was widely regarded in Europe and Asia as having shown how governments could overcome the severest obstacles and mobilise resources, create modern industries and allocate output in the national interest far better than capitalism. The temptation to use state controls in the drive to create peacetime prosperity and build new nations was overwhelming quite apart from the ideological attractions of socialism. See Anne O. Krueger, 'Policy Lessons from Development Experience since the Second World War', in Jere Behrman and T. N. Srinivasan (eds.), *Development Economics*, Vol. IIIB (Amsterdam: Elsevier, 1995), pp. 2501, 2504.
38. Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States*, p. xviii.
39. Contemporary reporting of these developments in the official media is summarised in Leo F. Goodstadt, 'Control and Motivation of the Chinese Labour Force since the Cultural Revolution', in Lee Ngok and Leung Chi-keung (eds.), *China: Development and Challenge*. Proceedings of the Fifth Leverhulme Conference, Vol. 2 (Hong Kong: Centre of Asian Studies, 1979), pp. 84–87.
40. Professor Liu Guoguang, Peking University, and Deputy Director, CASS Institute of Economics, 'Seminar on China's economy in the 1980s', *Wen Wei Po*, 8 March 1980. His address offers a very frank summary of the confusion about how best to manage economic reform in China at this date.
41. The challenges faced by management were amply illustrated in Contributing Commentator, 'Strive to develop industrial production, communications

- and transport with readjustment as the core', *Hongqi*, No. 8 (16 April 1981), pp. 2–4, 8.
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 44. How the bankers and their authority survived the Cultural Revolution is discussed in Leo F. Goodstadt, *China's Search for Plenty. The Economics of Mao Tse-tung* (New York: Weatherhill, 1973), pp. 188–92.
 45. Leo Goodstadt, 'Rethink on Chinese bank reforms', *Asiabanking*, September 1984, pp. 37–8.
 46. Zhou Xiaochuan, PBOC Governor, 'Opening to the Outside World: Past Experience and Prospects', speech at the conference to launch the *World Economic Development Declaration* (10 November 2003).
 47. The published statistics on foreign exchange reserves before 1992 can seem confusing. SAFE records that the reserves totalled only US\$ 167 million in 1978 and US\$ 840 million the following year. (SAFE, 'Foreign Exchange Reserves, 1950–2005' (URL: http://www.safe.gov.cn/model_safe_en/tjsj_en/tjsj_detail_en.jsp?ID=3030300000000000,14&id=4)). These SAFE figures exclude 'Bank of China Balances' that until 1991 were included in the published totals. (State Statistical Bureau, *China Statistical Yearbook 1992* (Beijing: Statistical Information and Consultancy Service Centre), T16.9. 'Gold and foreign exchange reserves', p. 603). The Bank of China's share exceeded, usually by very large amounts, the figure shown as 'Government Stock' in eight of the years between 1979 and 1991. SAFE's data thus considerably reduce the totals identified by the government at the time as official reserves. SAFE's practice, nevertheless, has prevailed since 1992 in China's publication of statistics on the reserves.
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 49. This summary of 1978–2007 growth and the supporting statistics are derived from Zhou Jianxiong, 'China's Foreign Trade: A History', *Beijing Review*, 10 September 2009; and NCNA: 'National Bureau of Statistics: China takes 7.7% of world trade volume', 27 October 2008; 'China top contributor to world economic growth', 3 October 2009; and 'Backgrounder: China's forex reserves and investment', 9 March 2010.
 50. Su Ning, PBOC Deputy Governor, 'Press ahead with Reform and Opening-up and Promote the Rapid and Healthy Development of the Financial Sector', speech at the Financial Summit Meeting (10 July 2006).

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52. Except where otherwise indicated, the analysis and quotations in this discussion of the 'transactional model' are drawn from the insightful review of China's strategy set in its wider international context by Katherina Pistor, 'Banking Reform in the Chinese Mirror', *Columbia Law and Economics Working Paper No. 354* (10 August 2009), pp. 5, 6, 7, 14, 15, 18, 22, 29.
53. The People's Bank took care to avoid any indication of which was regarded as most useful to China although the 'Anglo-Saxon' model came first in its list. Zhou Xiaochuan, PBOC Governor, 'Improve Corporate Governance and Develop Capital Market', speech at the *Euromoney* 'China Forum: Capital Market and Corporate Governance', Beijing (1 December 2004), p. 2.
54. Zhou, 'Instability and Evolution of the Financial System'.
55. CBRC, *2008 Annual Report* (n.d., n.p.), Box 2. 'Lessons from the global financial crisis', p. 32.
56. The quotations are from Gerard Caprio and Patrick Honohan, 'Restoring Banking Stability: Beyond Supervised Capital Requirements', *Journal of Economic Perspectives*, Vol. 13, No. 4 (Autumn 1999), p. 48. The authors did not identify any individual governments or suggest that they had China specifically in mind.
57. David Shambaugh, 'Is there a Chinese model?', *CD*, 1 March 2010.
58. Zhou, 'Instability and Evolution of the Financial System'.
59. A particularly impressive review of this mindset was presented by Zhou Xiaochuan, PBOC Governor, 'Learn Lessons from the Past for the Benefit of Future Endeavour', speech at the China Bond Market Development Summit, Beijing (20 October 2005), pp. 2, 5.
60. Real estate had slackened in 2007 (in response to tighter monetary policy), and industrial production had begun to fall from mid-2008 before the decline in export orders materialised. Thus, 'while the export slowdown exacerbated the economic slump, it was not the trigger'. Zhiwei Zhang and Honglin Wang, 'What triggered China's economic slowdown in 2008? The role of commodity price volatilities', *Hong Kong Monetary Authority Research Note 01/2010* (9 February 2010), pp. 2, 3 and 8.
61. Li Ruihan, Chinese People's Political Consultative Conference Chairman, *CD*, 7 November 2000.
62. See, for example, Cynthia Leung and Olaf Unteroberdoerster, 'Hong Kong SAR as a Financial Center for Asia: Trends and Implications', *IMF Working Paper WP/08/57* (March 2008), pp. 6, 9 and 13.
63. The report noted that 'some smaller joint stock commercial banks ... were as efficient as Hong Kong banks'. It concluded, nevertheless, that 'once Hong Kong banks are taken out [of the full study], the correlation between efficiency and profitability is close to zero for Chinese banks'. Tarhan Feyzioglu, 'Does Good Financial Performance Mean Good Financial Intermediation in China?', *IMF Working Paper WP/09/170* (August 2009), pp. 13, 17.

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66. Pak-wai Liu, Richard Yue-chim Wong, Yun-wing Sung and Pui-king Lau, *China's Economic Reform and Development Strategy of Pearl River Delta* (Hong Kong, Nanyang Commercial Bank Ltd, 1992), p. 127.
67. For a round-up of the sort of difficulties which bankers in Hong Kong were tackling, see Leo Goodstadt, 'A market place for funds and formulae', *Asian Banking*, July 1980, pp. 45–7.
68. Randall S. Jones, Robert E. King and Michael Klein, 'Economic Integration between Hong Kong, Taiwan and the Coastal Provinces of China', *OECD Economic Studies No. 20* (Spring 1993), pp. 116–7, 134 and 138.
69. Joseph Yam, HKMA Chief Executive, 'Speech British Chamber of Commerce', *HKMA*, 20 October 2006; and 'Hong Kong — New Opportunities as an International Financial Centre', *HKMA*, 8 May 2007.
70. The principal parallels are noted throughout Leo F. Goodstadt, 'Regulation and Financial Stability in Laissez-Faire Hong Kong: A Reassuring Record', in Greg N. Gregoriou (ed.), *The Banking Crisis Handbook* (London: CRC Press, 2010).
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72. For the data on these crises and their impact on Hong Kong's currency and financial markets, see Matthew S. Yiu, Wai-Yip Alex Ho and Lu Jin, 'A measure of financial stress in Hong Kong financial market — The financial stress index', *Hong Kong Monetary Authority Research Note 02/2010* (3 March 2010), pp. 2–8.
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74. Note the warnings in a study of culture defined as a much wider concept: 'Could it be that politics are the driving force and that culture just provides excuses? Culture would then provide arguments that help rationalize political arguments'. René M. Stulz and Rohan Williamson, 'Culture, openness, and finance', *Journal of Financial Economics*, Vol. 70 (2003), pp. 346, 347.
75. For a critical evaluation of their relationship, see Andrew Sheng, *From Asian to Global Financial Crisis: An Asian Regulator's View of Unfettered Finance in the 1990s and 2000s* (New York: Cambridge University Press, 2009), p. 110.

76. Claudio Borio and Gianni Toniolo, 'One hundred and thirty years of central bank cooperation: a BIS perspective', *BIS Working Papers No. 197* (February 2006), p. 23.
77. The irrelevance of the 'Washington consensus' to India and to China and other high-growth Asian economies is argued in Dani Rodrik, 'Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's "Economic Growth in the 1990s: Learning from a Decade of Reform"', *Journal of Economic Literature*, Vol. 44, No. 4 (December 2006), pp. 975, 979–80, 984–5.
78. Pistor, 'Banking Reform in the Chinese Mirror', p. 9.
79. See, for example, China's central bank view: 'Investing in US Treasury bills is "an important component of China's foreign currency reserve investments," People's Bank of China Vice-Governor Hu Xiaolian told a news conference ... the credit risk in continuing to buy US Treasuries is low in overall terms. Given that the US dollar is still the leading currency for international settlements, valuation and payment of trade, China will pay closer attention to the supervision of the international monetary system based on the US dollar'. Zhang Ran, 'Purchase of US Treasuries to continue', *CD*, 24 March 2009.
80. Zhou, 'Learn Lessons from the Past for the Benefit of Future Endeavour', pp. 4–5; 'Reform of the internal control and internal incentive systems of the commercial banks', speech at the *Beijing Finance Expo*, Beijing (1 September 2005), p. 1.
81. 'Examples of the [American exports] have included joint venture laws and regulations with regard to profit remission, labor provision, business contracts, patents, trademarks, and copyrights, etc., demanded by foreign multinationals for their own protection, along with new laws that developed as PRC property and business was privatized'. Meredith Woo-Cumings, 'Diverse Paths toward "the Right Institutions": Law, the State, and Economic Reform in East Asia', *ADB Institute Working Paper 18* (April 2001), pp. 11, 17. It should be said that Professor Woo does not commend 'Anglo-American discourse and experience, generalizing on the basis of a set of governmental institutions that are themselves anomalous survivors in the 21st century'. (p. 30)
82. The full text is 663-pages long including dissenting members' statements. In addition, the Commission has created a public archive containing the interview records, staff papers and all the other documentary and digital information obtained by the Commission or generated by its staff..
83. The potential overlap of roles has long been pointed out in Hong Kong in the case of prudential supervision in maintaining monetary as well as financial stability, even after the 1983 linked exchange rate with the American dollar. Sir John Cowperthwaite, Financial Secretary, *HHH*, 26 March 1969, p. 205; Papa N'Diaye, 'Macroeconomic Implications for Hong Kong SAR of Accommodative U.S. Monetary Policy', *IMF Working Paper WP/09/256* (November 2009), pp. 13–4.
84. This process and its consequences have been described by Ben S. Bernanke, FRB Chairman, 'Central Bank Independence, Transparency, and

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85. Not that these dangers can be excluded entirely. In a 2009 account of its response to the financial crisis, for example, the Securities and Exchange Commission stated: ‘Charged Fannie Mae and Freddie Mac with accounting fraud in 2006 and 2007 respectively, and the companies paid more than \$450 million in penalties to settle the SEC’s charges’. Few readers could be expected to follow the links shown to other webpages that revealed how both enforcement actions related to offences committed in 2004 or earlier and were thus unrelated to the current crisis. SEC, ‘SEC Actions During Turmoil in Credit Markets’ (22 January 2009) (URL: <http://www.sec.gov/news/press/sec-actions.htm>).
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Chapter 1

1. Andrew G Haldane, BoE Executive Director, ‘Rethinking the Financial Network’, speech at the Financial Student Association, Amsterdam (28 April 2009), pp. 9, 10.
2. Hector Sants, FSA Chief Executive, ‘The challenges facing bank regulation’, speech to the Association of Corporate Treasurers (14 May 2009).
3. Adrian Blundell-Wignall, Gert Wehinger and Patrick Slovik, ‘The Elephant in the Room: The Need to Deal with What Banks Do’, *OECD Journal: Financial Market Trends*, Vol. 2009, Issue 2, Table 2. ‘Major financial institutions’ write-downs and credit losses’, p. 11.
4. Sheila C. Bair, FDIC Chairman, Testimony on Regulatory Perspectives on Financial Regulatory Reform Proposals before the House of Representatives Financial Services Committee (24 July 2009).
5. Lord Turner, FSA Chairman in House of Commons Treasury Committee, *Banking Crisis*, Vol. I Oral evidence (London: HMSO, HC 144-I, March 2009), pp. EV280, 281.
6. Before the global crisis, this conclusion was supported by data derived from 60 countries relating to crises which occurred between 1980 and 2002 and presented in Romain Ranciere, Aaron Tornell and Frank Westermann, ‘Decomposing the Effects of Financial Liberalization: Crises vs. Growth’, *National Bureau of Economic Research Working Paper 12806* (December 2006). Some central bankers, nevertheless, acknowledged the very heavy costs that financial crises could inflict on an economy, e.g., David Clementi, BoE Deputy Governor, ‘Banks and Systemic Risk — Theory and Evidence’, speech at the Bank of England Conference (23 May 2001).
7. An impressive example of an evidence-based presentation in favour of the market’s wisdom was Mark J. Flannery, ‘Using Market Information in Prudential Bank Supervision: A Review of the U.S. Empirical Evidence’, *Journal of Money, Credit and Banking*, Vol. 30, No. 3, Part 1 (August 1998), pp. 297–8.

8. The classic expressions of this outlook came from Ben S. Bernanke as a governor of the Federal Reserve Board in ‘On Milton Friedman’s Ninetieth Birthday’, remarks at the Conference to Honor Milton Friedman, University of Chicago (8 November 2002); and Remarks at the Federal Reserve Bank of Dallas Conference on ‘The Legacy of Milton and Rose Friedman’s *Free to Choose*’, Dallas (24 October 2003).
9. The Bank of England denied that ‘the *Inflation Targeting* regime ... imposed a straightjacket on central banks including ours by setting too narrow a remit’. Sir John Gieve, BofE Deputy Governor, ‘Seven lessons from the last three years’ (19 February 2009), pp. 13–4.
10. Washington and London used almost identical wording on this issue, although in the British case, the bank closures since 2007 were without parallel since the nineteenth century. Ben S. Bernanke, FRB Chairman, ‘Financial Reform to Address Systemic Risk’, speech at the Council on Foreign Relations, Washington, DC (10 March 2009); House of Commons Treasury Committee, *Re-appointment of Mervyn King as Governor of the Bank of England Tenth Report of Session 2007–08*, Vol. II. Oral and written evidence (London: HMSO, HC 524-II, June 2008), p. EV4.
11. Clementi, ‘Banks and Systemic Risk — Theory and Evidence’. This view was shared by one of Asia’s most experienced regulators after an extensive survey of evidence from the last century. But his finding was challenged by an impressive essay in the same volume. Andrew Sheng, ‘Bank Restructuring Revisited’ and Geoffrey P. Miller, ‘Banking Crises in Perspective: Two Causes and One Cure’, in Gerard Caprio, Jr. et al. (eds.), *Preventing Bank Crises: Lessons from Recent Global Bank Failures* (Washington, DC: World Bank, 1998), pp. 280, 325.
12. Professor David Blanchflower, BofE Monetary Policy Committee Member, ‘The Future of Monetary Policy’, Open Lecture at Cardiff University (March 2009), pp. 1, 9.
13. This finding reflects a study of the principal regulatory issues in the light of data gathered from 107 countries at the end of the previous century presented in James R. Barth, Gerard Caprio, Jr. and Ross Levine, ‘Bank Regulation and Supervision: What Works Best?’, *National Bureau of Economic Research Working Paper Series, Working Paper 9323* (November 2002).
14. For a summary of the key issues, see Sanghoon Ahn and Philip Hemmings, ‘Policy Influences on Economic Growth in OECD Countries: An Evaluation of the Evidence’, *Economics Department Working Papers No. 246* (Paris: OECD, 2000), pp. 41–3.
15. Paul Tucker, BofE Deputy Governor, ‘Financial Crisis and G20 Financial Regulatory Reform: An Overview’, remarks at the FSB and Korean G20 Presidential Committee Conference, Korea (3 September 2010), p. 3.
16. ‘Financial economics. Efficiency and beyond’, *Economist*, 16 July 2009. This verdict was promptly challenged by the University of Chicago’s Professor Robert Lucas, ‘In defence of the dismal science’, *Economist*, 6 August 2009.
17. Not until almost two years after leaving office did President George W. Bush publicly attack officials for their light-touch regulation before 2007. “We were blindsided by a financial crisis that had been more than a decade in the making”: his focus, he writes [in his newly-published autobiography],

- “had been kitchen-table economic issues like jobs and inflation. I assumed any major credit troubles would have been flagged by the regulators or rating agencies.” Michiko Kakutani, ‘In Bush Memoir, Policy Intersects With Personality’, *New York Times*, 4 November 2010.
18. US Treasury, ‘The Role of the Federal Reserve in Preserving Financial and Monetary Stability: Joint Statement by the Department of the Treasury and the Federal Reserve’ (23 March 2009).
 19. House of Commons Treasury Committee, *Re-appointment of Mervyn King as Governor of the Bank of England Tenth Report of Session 2007–08*, Vol. I. Report together with formal minutes (London: HMSO, April 2008), p. 11.
 20. British politicians were not so convinced, however, about the importance of the financial sector in the British economy judged by international standards. See House of Commons Treasury Committee, *Banking Crisis: regulation and supervision, Fourteenth Report of Session 2008–09* (London: HMSO, HC 767, 21 July 2009), pp. 48, 49.
 21. ‘Over the past few months there has been renewed talk of London overtaking New York as the world’s leading financial centre. And it has reflected fears in the US as much as self congratulation in this country.’ Sir John Gieve, BofE Deputy Governor, ‘The City’s Growth: The Crest of a Wave or Swimming with the Stream?’, speech to the Society of Chartered Accountants, London (26 March 2007), p. 2.
 22. Craig Doidge, G. Andrew Karolyi and René M. Stulz, ‘Has New York become less competitive in global markets? Evaluating foreign listing choices over time’, *Journal of Financial Economics*, Vol. 91, Issue No. 3 (March 2009), pp. 254, 255, 256–7.
 23. Joe Nocera, ‘Talking Business: New York and London: Twins in Finance and Folly’, *New York Times*, 9 May 2009.
 24. Claudio Borio and Gianni Toniolo, ‘One hundred and thirty years of central bank cooperation: a BIS perspective’, *BIS Working Papers No. 197* (February 2006), p. 21.
 25. Ethan B. Kapstein, ‘Resolving the Regulator’s Dilemma: International Coordination of Banking Regulations’, *International Organization*, Vol. 43, No. 2 (Spring 1989), pp. 328–9.
 26. The analysis in this paragraph is based on an impressive analysis of the early stages of the Anglo-American consensus at work in David Andrew Singer, ‘Capital Rules: The Domestic Politics of International Regulatory Harmonization’, *International Organization*, Vol. 58, No. 3 (Summer 2004), pp. 550–1, 554–60. The author does not use this terminology, however.
 27. Joan E. Spero, ‘Guiding Global Finance’, *Foreign Policy*, No. 73 (Winter, 1988–89), pp. 115–6.
 28. Gerard Carpio and Patrick Honohan, ‘Restoring Banking Stability: Beyond Supervised Capital Requirements’, *Journal of Economic Perspectives*, Vol. 13, No. 4 (Autumn 1999), p. 51.
 29. Heath Price Tarbert, ‘Are International Capital Adequacy Rules Adequate? The Basle Accord and beyond’, *University of Pennsylvania Law Review*, Vol. 148, No. 5 (May 2000), pp. 1782, 1784–5.
 30. Camille M. Caesar, ‘Capital-Based Regulation and U. S. Banking Reform’, *Yale Law Journal*, Vol. 101, No. 7 (May 1992), pp. 1534–5.

31. Michael R. King and Timothy J. Sinclair, 'Private Actors and Public Policy: A Requiem for the New Basel Capital Accord', *International Political Science Review/Revue internationale de science politique*, Vol. 24, No. 3 (July 2003), pp. 349, 351, 356.
32. On these differences and their significance, see Howell E. Jackson, 'An American Perspective on the U.K. Financial Services Authority: Politics, Goals & Regulatory Intensity', *Harvard Law School Discussion Paper No. 522* (08/2005), pp. 4, 12 especially.
33. 'The time has long past where we can calmly accept that the role of the central bank is let asset price bubbles burst and pick up the pieces afterwards. That was the Fed's mantra; it can no longer be the case ... some would attribute the asset price bubble at least partly to the Fed's own actions, specifically its policy of holding interest rates at extremely low levels for nearly three years (from the end of 2001 to the end of 2004).' Thomas Huertas, FSA Banking Sector Director, 'The Outlook for Banking and Banking Regulation', speech at the ICFR Inaugural Summit, London (1 April 2009).
34. The SEC chairman described how 'as the regulators of two of the world's major market centres, the SEC and the FSA have a strong interest in collaborating [to] ... achieve coherent oversight of global actors and limit opportunities for playing the regulatory seams'. In a joint statement, the FSA Chief Executive declared that 'the strategic dialogue with the SEC is a valuable component of the discussions around these reforms, particularly in areas of joint interest and in identifying potential regulatory gaps.' Hector Sants, FSA Chief Executive, and Mary Schapiro, SEC Chairman, 'FSA and SEC discuss approaches to global regulatory requirements', *FSA Press Release FSA/PN/124/2009 916* (16 September 2009).
35. Beth A. Simmons and Zachary Elkins, 'The Globalization of Liberalization: Policy Diffusion in the International Political Economy', *American Political Science Review*, Vol. 98, No. 1 (February 2004), pp. 180, 186, 187.
36. But American pressures on the region's weaker governments in the run-up to the 1997–98 Asian financial crisis and during its management should not be ignored. See John Williamson, 'The Years of Emerging Market Crises: A Review of Feldstein', *Journal of Economic Literature*, Vol. 42, No. 3 (September 2004), pp. 822–37.
37. Beth A. Simmons, 'The International Politics of Harmonization: The Case of Capital Market Regulation', *International Organization*, Vol. 55, No. 3 (Summer, 2001), pp. 592–5. This process did not imply that at the level of the firm (rather than the regulatory environment), Anglo-American norms would set the rules. The complexity of the response of foreign corporations to the norms of American boardroom culture as globalisation accelerated was well illustrated by Gerald F. Davis and Christopher Marquis, 'The Globalization of Stock Markets and Convergence in Corporate Governance', in Victor Nee and Richard Swedberg (eds.), *The Economic Sociology of Capitalism* (Princeton: Princeton University Press, 2005), pp. 360, 362, 364, 385–6 in particular.
38. Darryl Crawford, 'Globalisation and Guanxi: The Ethos of Hong Kong Finance', *New Political Economy*, Vol. 6, No. 1 (2001), p. 47.

39. James R. Barth, Gerard Caprio, Jr. and Ross Levine, 'Bank Regulation and Supervision: What Works Best?', *National Bureau of Economic Research Working Paper Series, Working Paper 9323* (November 2002), p. 1.
40. A typical example of such reassurance to the world at large was an American central banker's detailed review of financial innovation which advised that 'the potential for the new instruments and techniques [i.e., mortgage-based and other derivatives] to produce instability has been overestimated'. Roger W. Ferguson, Jr., FRB Vice Chairman, 'Financial Engineering and Financial Stability', remarks at the Annual Conference on the Securities Industry, American Institute of Certified Public Accountants and the Financial Management Division of the Securities Industry Association, New York (20 November 2002).
41. Richard Spillenkothen, FRB Director, 'Oversight of investment banks' response to the lessons of Enron', testimony before the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs (11 December 2002).
42. On the difference in constraints on regulators and legislators, see Singer, 'Capital Rules: The Domestic Politics of International Regulatory Harmonization', *International Organization*, p. 543.
43. The conflicting national interests among Eurozone leaders were very public. See for example the reporting in Carter Dougherty, 'European Central Bank resists rush to print more money', *International Herald Tribune*, 24 March 2009; *Economist*: 'The European Union's week from hell', 9 October 2008 and 'Central banks' exit strategies: This way out', 4 June 2009.
44. Data on the varied impact of the global crisis on the United States, the United Kingdom and individual members of the EU, and their very national responses, are summarised in Mark Horton et al., 'The State of Public Finances: A Cross-Country Fiscal Monitor', *IMF Staff Position Note SPN/09/21* (30 July 2009), pp. 28–30.
45. This hostility was well reported in Jack Ewing and Steve Erlanger, 'Trichet Faces Growing Criticism in Europe Crisis', *New York Times*, 21 May 2010.
46. For a post-global crisis summary of the British regulators' sense of Greenspan's influence, see Lord Turner's comments in House of Commons Treasury Committee, *Banking Crisis*, pp. EV280, 281.
47. Alan Greenspan, *The Age of Turbulence: Adventures in a New World* (New York: Penguin Press, 2007), p. 489.
48. Ben S. Bernanke, FRB Chairman, 'Hedge Funds and Systemic Risk', speech at the Federal Reserve Bank of Atlanta's 2006 Financial Markets Conference, Georgia (16 May 2006).
49. Greenspan, *The Age of Turbulence: Adventures in a New World*, pp. 375–6.
50. But note that earlier in this speech, he had declared: 'We must ensure that an institutional memory is maintained so that the lessons from the crisis are not forgotten and those impediments to excessive risk-taking are not swept away once memories of the crisis recede.' Mervyn King, BoE Governor, 'Finance: A Return from Risk', speech to the Worshipful Company of International Bankers (17 March 2009), pp. 4, 15.

51. Charles W. Calomiris, 'The Political Lessons of Depression-Era Banking Reform' (April 2010), *Oxford Review of Economic Policy* (forthcoming), pp. 29–30.
52. Significantly, while he pledged that 'authorities should (and will) try to ensure that the lapses in risk management of 1998 do not happen again', he warned that this 'systemic risk' could not be eliminated: 'To try to do so would likely stifle innovation without achieving the intended goal.' Bernanke, 'Hedge Funds and Systemic Risk'.
53. Sheila C. Bair, FDIC Chairman, Testimony on Modernizing Bank Supervision and Regulation before the Senate Committee on Banking, Housing and Urban Affairs (19 March 2009).
54. Robert Z. Aliber, 'Financial Innovation and the Boundaries of Banking', *Managerial and Decision Economics*, Vol. 8, No. 1 (March 1987), pp. 67–8.
55. See the prescient observations in Joan E. Spero, 'Guiding Global Finance', *Foreign Policy*, No. 73 (Winter 1988–89), pp. 114–5, 117–8, 121–2.
56. Simmons and Elkins, 'The Globalization of Liberalization: Policy Diffusion in the International Political Economy', *American Political Science Review*, p. 171.
57. Dani Rodrik, 'Goodbye Washington Consensus, Hello Washington Confusion? A Review of the World Bank's "Economic Growth in the 1990s: Learning from a Decade of Reform"', *Journal of Economic Literature*, Vol. 44, No. 4 (December 2006), p. 975.
58. See the comments based on a reference frame of '86 episodes of banking insolvency in 69 countries between the late 1970s and the early 1990s' in King and Sinclair, 'Private Actors and Public Policy: A Requiem for the New Basel Capital Accord', *International Political Science Review*, p. 349.
59. C. A. E. Goodhart, 'Why Do Banks Need a Central Bank?', *Oxford Economic Papers*, Vol. 39, No. 1 (March 1987), pp. 87–8; Gary Gorton and Andrew Winton, 'Banking in Transition Economies: Does Efficiency Require Instability?', *Journal of Money, Credit and Banking*, Vol. 30, No. 3, Part 2 (August 1998), p. 625.
60. A study of 24 emerging economies between 1975 and 1997 concluded that the estimated losses they suffered 'should alarm policymakers'. Michael M. Hutchison and Ilan Noy, 'How Bad are Twins? Output Costs of Currency and Banking Crises', *Journal of Money, Credit, and Banking*, Vol. 37, No. 4 (August 2005), p. 748.
61. 'A Short History of Modern Finance', *Economist*, 16 October 2008.
62. Elizabeth A. Duke, FRB Governor, 'Credit availability and prudent lending standards', testimony before the House of Representatives Committee on Financial Services (25 March 2009).
63. Kevin Warsh, FRB Governor, 'The Panic of 2008', speech at the Council of Institutional Investors 2009 Spring Meeting, Washington, DC (6 April 2009).
64. Huertas, 'The Outlook for Banking and Banking Regulation'.
65. Andrea Beltratti and René M. Stulz, 'The Credit Crisis Around the Globe: Why Did Some Banks Perform Better?', *Dice Center WP 2010–05* (March 2010), pp. 13–4.
66. Lord Turner, FSA Chairman, *The Turner Review: A regulatory response to the global banking crisis* (London: Financial Services Authority, March 2009), pp. 45–6.

67. Warsh, 'The Panic of 2008'.
68. 'But the blunt fact is that even if we had had a better supervisory process in place, it would have made only a small difference to the evolution of the financial crisis in the UK.' Lord Turner, FSA Chairman, 'Building a more stable global banking system', speech at the Global Financial Forum, New York (27 April 2009).
69. Paul Tucker, BofE Deputy Governor, Remarks at The Turner Review Conference (27 March 2009).
70. Kevin Warsh, FRB Governor, 'Regulation and Its Discontents', speech at the New York Association for Business Economics, New York (3 February 2010).
71. Mervyn King, BofE Governor, 'Banking: From Bagehot to Basel, and Back Again', speech to the Buttonwood Gathering, New York (25 October 2010), p. 17.
72. The Federal Reserve Board Chairman, himself a distinguished academic, concluded a proposed agenda for economic research with the assertion: 'The financial crisis did not discredit the usefulness of economic research and analysis by any means; indeed, both older and more recent ideas drawn from economic research have proved invaluable to policymakers attempting to diagnose and respond to the financial crisis.' Ben S. Bernanke, FRB Chairman, 'Implications of the Financial Crisis for Economics', speech at the Conference Co-sponsored by the Center for Economic Policy Studies and the Bendheim Center for Finance, Princeton University (24 September 2010).

Chapter 2

1. Editorial, 'It's the Regulations, Not the Regulator', *New York Times*, 18 March 2009.
2. Ken Hogg, FSA Insurance Sector Director, 'Key priorities in regulation — outlining the FSA's strategy', speech at the Future of Life Assurance IEA Conference (19 May 2010).
3. Financial Crisis Inquiry Commission, *Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States* (Official Government Edition, 21 January 2011), chapter 1, 'Before our very eyes'.
4. Mervyn King, BofE Chairman, 'Finance: A Return from Risk', speech to the Worshipful Company of International Bankers (17 March 2009), p. 15.
5. Sheila C. Bair, FDIC Chairman, Testimony on Modernizing Bank Supervision and Regulation before the Senate Committee on Banking, Housing and Urban Affairs (19 March 2009).
6. *ibid.*
7. Lord Turner, FSA Chairman, 'Protecting Consumers and Winning Trust', speech at the British Bankers' Association Conference (13 July 2010).
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10. This point was made in an early reaction to 'big bang' deregulation of British financial markets. John Kay et al., 'Regulatory reform in Britain', *Economic Policy*, Vol. 3, No. 7 (October 1988), p. 288.

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12. Karin Knorr Cetina and Urs Bruegger, 'Global Microstructures: The Virtual Societies of Financial Markets', *American Journal of Sociology*, Vol. 107, No. 4 (January 2002), pp. 906, 910–1, 939, 942–4.
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14. Hector Sants, FSA Chief Executive, 'Do regulators have a role to play in judging culture and ethics?', speech at the Chartered Institute of Securities and Investments Conference (17 June 2010).
15. Lord Turner, FSA Chairman, 'Priorities for the reform of global regulation — challenging past assumptions', speech at IOSCO 2009, Tel Aviv (11 June 2009).
16. For a belated acknowledgment of the parallels, see Bernanke, 'Financial Reform to Address Systemic Risk'.
17. Among the regulators' challenges in the Asian financial crisis (which were to prove no less menacing in the current global crisis) were the quality of corporate information and the severe pressure on bank credit triggered by sharp falls in share prices. Alastair Clark, BofE Executive Director, 'Accounting Standards and International Financial Markets', speech at the Institute of Chartered Accountants in Banking, Dublin (3 May 2000); David Clementi, BofE Deputy Governor, 'Banks and Systemic Risk — Theory and Evidence', speech at the Bank of England Conference (23 May 2001).
18. World Bank, *The East Asian Miracle. Economic Growth and Public Policy* (New York: Oxford University Press, 1993), pp. 1–2.
19. This topic is analysed in some depth in World Bank, *Managing Capital Inflows in East Asia* (Washington: World Bank, 1995). See also Manuel Guitián, 'The Challenge of Managing Global Capital Flows', *Finance and Development*, Vol. 35, No. 2 (June 1998), pp. 14–7.
20. Stijin Claessens and Simeon Djankov, 'Publicly-Listed East Asian Corporates: Growth, Financing and Risks', paper presented to the Regional Conference on Asian Corporate Recovery: Corporate Governance, Government Policy (World Bank, 15 March 1999).
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23. A good summary of the ITICs, their history, role and problems can be found in Solomon Smith Barney, 'Fixed Income – Local Government ITIC Credits', 26 November 1998.

24. See Markus Taube, 'Economic Relations between the PRC and the States of Europe', *China Quarterly*, No. 169 (March 2002), p. 103.
25. Alistair Darling, M.P., Chancellor of the Exchequer, in House of Commons Treasury Committee, *Banking Crisis*, Vol. I. Oral evidence (London: HMSO, HC 144-I, March 2009), p. EV366. It should be noted that officials offered another, less compressed and more objective listing of the external factors: 'Large current account surpluses accumulated in the oil-exporting countries, Japan and some other east Asian developing nations, while fiscal and current account deficits grew in the US, UK and some members of the Eurozone'. FSA, 'Memorandum from the Financial Services Authority (FSA)', in House of Commons Treasury Committee, *Banking Crisis*, Vol. II. Written evidence (London: HMSO, HC 144-II, March 2009), p. EV 456.
26. Charles Bean, BoE Deputy Governor, 'Some Lessons for Monetary Policy from the Recent Financial Turmoil', remarks at the Conference on Globalisation, Inflation and Monetary Policy (22 November 2008), pp. 2–3.
27. Ben S. Bernanke, FRB Chairman, 'Four Questions about the Financial Crisis' speech at the Morehouse College, Atlanta, Georgia (14 April 2009).
28. Bernanke, 'Financial Reform to Address Systemic Risk'. As early as 1996, China had the world's fourth largest foreign exchange reserves. *NCNA*, 21 April 1996.
29. King, 'Finance: A Return from Risk', p. 15.
30. Christopher Cox, SEC Chairman, Address to the Joint Meeting of the Exchequer Club and Women in Housing and Finance (4 December 2008).
31. These figures are derived from Bank of England estimates published in House of Commons Treasury Committee, *Financial Stability and Transparency Sixth Report of Session 2007–08* (London: HMSO, HC 371, March 2008), p. 17.
32. Sir John Gieve, BoE Deputy Governor, 'Uncertainty, policy and financial markets', speech at the Barbican Centre (24 July 2007), pp. 7–8.
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37. Sheila C. Bair, FDIC Chairman, Remarks to the Global Association of Risk Professionals, New York (25 February 2008).
38. Data on the declining quality of these mortgages and their market impact were provided by Sheila C. Bair, FDIC Chairman, Testimony on the State of the Banking Industry before the Senate Committee on Banking, Housing and Urban Affairs (4 March 2008).
39. The decline in standards of loan screening was substantiated in a study based on data covering 90 per cent of all sub-prime loans that were securitised. Benjamin J. Keys et al., 'Did Securitisation Lead to Lax Screening? Evidence

- from Sub-prime Loans’, *EFA 2008 Athens Meetings Paper* (December 2008), pp. 1, 5, 28.
40. David Clementi, BoE Deputy Governor, ‘Property and the Economy’, speech at the Chartered Surveyors Livery Company International Dinner (29 April 2002), pp. 2–3, 4–5, 10.
 41. House of Commons Treasury Committee, *The run on the Rock Fifth Report of Session 2007–08*, Vol. I (London: HMSO, HC56-I, January 2008), p. 35.
 42. Cox, Joint Meeting of the Exchequer Club and Women in Housing and Finance.
 43. Kathleen L. Casey, SEC Commissioner, ‘Remarks at the Commission Open Meeting’ (3 December 2008).
 44. Note, for example, how the British Accountancy & Actuarial Discipline Board launched investigations into allegations against auditors: ‘AADB Investigating Auditors’ Role in Relation to JP Morgan Securities Ltd.’s Compliance with FSA Client Asset Rules’, *AADB PN 24* (4 October 2010); ‘AADB Investigating Auditors’ Role in Relation to Lehman Brothers’ Compliance with FSA Client Asset Rules’, *AADB PN 25* (4 October 2010). There have been complaints, however, that the accounting profession’s own audit standards were badly flawed and led bank executives to unwittingly over-estimate their financial stability. Louise Armitstead, ‘Coalition admits concerns over “flawed” IFRS’, *Daily Telegraph*, 27 August 2010. In addition, the approach that auditors ought to take is a matter of dispute between financial and securities regulators. See Lord Turner, FSA Chairman, ‘Banks are different: should accounting reflect that fact?’, speech at the Institute of Chartered Accountants in England and Wales, London (21 January 2010).
 45. The analysis and quotations in this paragraph are drawn from a useful summary of the ratings agencies’ historical role in American and other financial markets, together with a prescient review of the dangers inherent in the expanded role which the Basel arrangements conferred on them, in King and Sinclair, ‘Private Actors and Public Policy: A Requiem for the New Basel Capital Accord’, *International Political Science Review*, pp. 351–3, 358–9.
 46. The quotations are from Basel Committee on Banking Supervision, *A New Capital Adequacy Framework, Consultative Paper* (Basel: Bank for International Settlements, June 1999), pp. 13, 26, 36.
 47. This case is made by Vanessa Redak, ‘Risks, Ratings and Regulation: Toward a Reorganization of Credit via Basel II?’, in Peter Mooslechner et al. (eds.), *The Political Economy Of Financial Market Regulation: The Dynamics of Inclusion and Exclusion* (Cheltenham: Edward Elgar Publishing Ltd, 2006), pp. 199–200.
 48. ‘Just as Basel I created incentives for behavior in the financial markets which undermined the intent of the initial Capital Adequacy Accord, the political economy of bond rating ... may be the weakest link in the Basel II proposals’. Michael R. King and Timothy J. Sinclair, ‘Private Actors and Public Policy: A Requiem for the New Basel Capital Accord’, *International Political Science Review/Revue internationale de science politique*, Vol. 24, No. 3 (July 2003), p. 358.
 49. Sir Andrew Large, BoE Deputy Governor, ‘Financial Stability Oversight, Past & Present’, speech at the London School of Economics (22 January 2004), pp. 14–5.

50. Sheila C. Bair, FDIC Chairman, Remarks at the Bear Stearns Mortgage and Structured Product Conference, New York (17 January 2008).
51. Nigel Jenkinson, BofE Financial Stability Executive Director, et al., ‘Financial Innovation: What Have We Learnt?’, Reserve Bank of Australia Conference on Lessons from the Financial Turmoil of 2007 and 2008 (14–15 July 2008), pp. 10–11.
52. Casey, ‘Remarks at the Commission Open Meeting’.
53. Bernanke, ‘Four Questions about the Financial Crisis’.
54. There is some confusion about the links between banking and insurance. A leading British regulator stated, for example, that ‘in general, insurance companies did not play a major role’ in the international financial crisis and then went on to list an extensive range of insurance activities directly linked to banking stability. Lord Turner, FSA Chairman, Address to the IAIS Annual Conference, Dubai (27 October 2010).
55. House of Commons Treasury Committee, *Financial Stability and Transparency Sixth Report of Session 2007–08*, pp. 18, 20, 23, 25.
56. David Clementi, BofE Deputy Governor, ‘Crisis prevention and resolution — two aspects of financial stability’, Inaugural Lecture at the South Bank University Centre for Monetary and Financial Economics (6 September 2000).
57. Sir Andrew Large, BofE Deputy Governor, ‘Convergence in Insurance and Banking: Some Financial Stability Issues’, speech at the Mandarin Oriental Hotel (12 June 2003), pp. 4–5.
58. This analysis of the American outlook, together with the quotations, is drawn from Roger W. Ferguson, Jr., FRB Vice Chairman, ‘Financial Engineering and Financial Stability’, remarks at the Annual Conference on the Securities Industry, American Institute of Certified Public Accountants and the Financial Management Division of the Securities Industry Association, New York (20 November 2002).
59. Bair, Testimony on Modernizing Bank Supervision and Regulation before the Senate Committee on Banking, Housing and Urban Affairs.
60. Adrian Blundell-Wignall, Gert Wehinger and Patrick Slovik, ‘The Elephant in the Room: The Need to Deal with What Banks Do’, *OECD Journal: Financial Market Trends*, Vol. 2009, Issue 2, Table 2. ‘Major financial institutions’ write-downs and credit losses’, p. 11.
61. Cox, Address to the Joint Meeting of the Exchequer Club and Women in Housing and Finance.
62. Details of the criminal activities were provided by Elisse B. Walter, SEC Commissioner, Testimony Concerning Securities Law Enforcement in the Current Financial Crisis before the United States House of Representatives Committee on Financial Services, 20 March 2009.
63. King, ‘Finance: A Return from Risk’, p. 6.
64. Kevin Warsh, FRB Governor, ‘The Panic of 2008’, speech at the Council of Institutional Investors 2009 Spring Meeting, Washington, DC (6 April 2009).
65. Bair, Testimony on Modernizing Bank Supervision and Regulation before the Senate Committee on Banking, Housing and Urban Affairs.

66. Daniel K. Tarullo, FRB Governor, 'Financial Regulatory Reform', speech at the U.S. Monetary Policy Forum, New York (26 February 2010).
67. Sheila C. Bair, FDIC Chairman, 'Restoring the Strength and Vitality of the U.S. Financial System', remarks before the Risk Management Association, Baltimore (18 October 2010).
68. Consumer protection was presented literally as 'a word' concluding the Chairman's congressional testimony. Ben S. Bernanke FRB Chairman, 'Regulatory restructuring', testimony before the House of Representatives Committee on Financial Services (24 July 2009).
69. See the patronising reference to 'a nostalgic elegy for a past age of innocence and stability: with Captain Mainwaring back behind the desk in the branch at Walmington-on-Sea casting a censorious eye over any householder or small-business man silly enough to want to take on too much credit, while the wide boys of the City and Wall Street are free to speculate but well away from sober middle England'. Lord Turner, FSA Chairman, 'The financial crisis and the future of financial regulation', The Economist's Inaugural City Lecture (21 January 2009).
70. HMG, *Reforming financial markets* (Cm 7667/2009), p. 14.
71. Ben S. Bernanke, FRB Chairman, 'Financial Innovation and Consumer Protection', speech at the Sixth Biennial Community Affairs Research Conference, Washington, DC (17 April 2009).
72. Elizabeth A. Duke, FRB Governor, 'Consumer protection', testimony before the House of Representatives Subcommittee on Domestic Monetary Policy and Technology, Committee on Financial Services (16 July 2009).
73. These criticisms of the Federal Reserve's performance are summarised from Sheila C. Bair, FDIC Chairman, Statement on the Causes and Current State of the Financial Crisis before the Financial Crisis Inquiry Commission (14 January 2010).
74. Mervyn King, BoE Governor, Speech at the Lord Mayor's Banquet for Bankers and Merchants, London (16 June 2010), p. 5.
75. Lord Turner, FSA Chairman, Mansion House Speech, London (21 September 2010).
76. For examples of litigation relating to anti-arthritis drugs, pain-killers and anti-depressants and the manufacturers' failures to respond to warnings from their own executives, see *New York Times*: Stephanie Saul, 'Merck Wrote Drug Studies for Doctors', 16 April 2008; Barry Meier, '3 Executives Spared Prison in OxyContin Case', 21 July 2007; Barry Meier and Benedict Carey, 'Drug maker is accused of fraud', 26 February 2009; Gardiner Harris and Duff Wilson, 'Whistle-blower cases rock drug industry', 28 October 2010.
77. King, 'Finance: A Return from Risk', p. 6.
78. A saving clause was added: 'If we cannot afford to have them fail, then they should be regulated so as to prevent imposing systemic risk.' Ethiopis Tafara, SEC Director, 'A Few Observations Based On International Regulatory Conversations', speech at the CESR Conference, Paris (23 February 2009).
79. Sheila C. Bair, FDIC Chairman, Statement on Implementing the Dodd-Frank Wall Street Reform and Consumer Protection Act before the Senate Committee on Banking, Housing, and Urban Affairs (30 September 2010).

80. Kevin Warsh, FRB Governor, 'Regulation and Its Discontents', speech at the New York Association for Business Economics, New York (3 February 2010).
81. King, Speech at the Lord Mayor's Banquet for Bankers and Merchants, p. 5
82. This affair was part of the collective memory of British regulators on the eve of the global crisis. See Ian Bond, BoE Financial Crisis Management Division Head, 'Managing a Bank-specific Crisis: A UK Perspective', BBA workshop on managing a bank-specific crisis (26 October 2006), p. 1.
83. Norma Cohen, 'Regulation: Doubts over political resolve for reform', *Financial Times*, 5 October 2009. Dismay about the slow pace of reform has been voiced, albeit diplomatically, by the IMF Managing Director. Dominique Strauss-Kahn, 'Beyond the Crisis: Sustainable Growth and a Stable International Monetary System', Sixth Annual Bundesbank Lecture (4 September 2009).

Chapter 3

1. This author points out that this view was always implausible. Guy de Jonquières, 'China and the global economic crisis', *ECIPE Policy Briefs No. 02/2009*, p. 1. The *Economist* recorded the prevalence of this mood in 2008: e.g., 'From Mao to the mall: Amid all the global gloom, the good news is that China is turning into a nation of spenders, as well as sellers', 14 February 2008; 'The credit crunch China moves to centre stage: In a whirl of financial summity, China ponders how to wield its new-found clout', 30 October 2008; 'Reflating the dragon: Can the world's fastest-growing economy avoid a sharp downturn?', 13 November 2008.
2. Wang Xiuqiong and Chang Ai'ling, 'Premier Wen says financial crisis not bottom out, impact spreading', *NCNA*, 28 February 2009.
3. For example, 'President Hu: China's economic development faces challenges', *NCNA*, 29 November 2008; Ambrose Evans-Pritchard, 'Global investors see Chinese green shoots', *Daily Telegraph*, 19 February 2009.
4. This attitude seemed clear enough among China's central bankers in 2007. See Zhou Xiaochuan, PBOC Governor, 'Instability and Evolution of the Financial System' (5 December 2007), pp. 1–7.
5. People's Bank of China, *Annual Report 2008* (n.d., n.p.), p. 36.
6. The vulnerability was being described in sombre terms even after the global crisis itself was over. 'The banking industry still faces great risks. Banks should be clear about the situation and make relentless efforts to manage risks'. Liu Mingkang, CBRC Chairman, 'Chinese regulators highlight precautions against financial risks before Seoul Summit', *NCNA*, 11 November 2010.
7. 'The correlation between efficiency and profitability is close to zero for Chinese banks'. Tarhan Feyzioglu, 'Does Good Financial Performance Mean Good Financial Intermediation in China?', *IMF Working Paper WP/09/170* (August 2009), pp. 17, 19, 26.
8. Based on Feyzioglu, 'Does Good Financial Performance Mean Good Financial Intermediation in China?', *IMF Working Paper WP/09/170*, pp. 20–1 and Table 6. 'The Banking System, 2008', p. 22. Numbers of rural credit cooperatives and finance companies are as shown in China Banking Regulatory Commission, *2008 Annual Report* (n.d., n.p.), p. 148.

9. 'China has established a comprehensive socialist legal system that governs all sectors of social life and provides a legal basis for the nation's economic and social construction ... The system ensures, legally and institutionally, that the Communist Party of China (CPC) will always be at the core of the leadership'. Wu Bangguo, Standing Committee Chairman of the National People's Congress, 'China will stick to socialism as required by law: top legislator', *NCNA*, 25 January 2011.
10. A well-illustrated analysis of how and why the economic reforms did not undermine the institutional dominance traditionally exercised by the Chinese Communist Party is Lance L. P. Gore, 'The Communist Legacy in Post-Mao Economic Growth', *China Journal*, No. 41 (January 1999), pp. 25–54.
11. Zhou Xiaochuan, PBOC Governor, 'Improve Corporate Governance and Develop Capital Market', speech at the *Euromoney* 'China Forum: Capital Market and Corporate Governance', Beijing (1 December 2004), pp. 1, 2.
12. Zhou Xiaochuan, PBOC Governor, Address at the Global Think-tank Summit (3 July 2009), p. 6.
13. For example, by 2010, all private law firms had their own Party organisations, as did 'more than 62 per cent of the country's accounting firms' (compared with only 20 per cent a year earlier). Li Yuanchao, Party Organisation Department Head, 'Senior official calls for enhanced Party building in new social strata, professions', *NCNA*, 27 January 2010.
14. David Murphy, 'Bank on Zhou: China's tough stockmarket regulator becomes central bank chief to boost confidence', *Far Eastern Economic Review*, 9 January 2003.
15. On the status and related problems of the PBOC and the CBRC, see Hui Huang, 'Institutional structure of financial regulation in China: Lessons from the global financial crisis', *Journal of Corporate Law Studies*, Vol. 10, Part 1 (April 2010), pp. 234–5.
16. Pan Yue, State Environmental Protection Administration (SEPA) Vice Director, 'More efforts needed to implement environmentally-friendly loan policy', *NCNA*, 13 February 2008.
17. In fact the banks had already been subject to a PBOC directive in 2008 setting out several, similar restrictions to the 'Guidance'. Hu Xiaolian, PBOC Deputy Governor, Speech at the Buenos Aires Money and Banking Conference, Buenos Aires (1 September 2008).
18. The 'Guidance' directed enforcement of 'strict controls on market access, reinforced environmental supervision, and tougher controls over land use. *Banks were ordered to lend money for these sectors in strict accordance with present industrial policies*'. (emphasis added) 'China to address overcapacity in emerging sectors', *NCNA*, 26 August 2009. Similar examples could be cited from other policy areas, including relocation of existing manufacturing facilities from Shanghai and Guangdong to Western provinces and pricing policies for fuel and power.
19. 'China to speed up elimination of outdated production capacity', *NCNA*, 21 January 2010. The Prime Minister's remarks were reported in 'China's overcapacity no relation to central government investment', *NCNA*, 27 December 2009.

20. See, for example, Zhou, 'Improve Corporate Governance and Develop Capital Market', pp. 1–6. A strong case for this principle in banking was also made by Wu Xiaoling, PBOC Deputy Governor, Remarks on the International Seminar on the Tenth Anniversary of the Asian Financial Crisis (21 June 2007), p. 4.
21. Chen Bin, National Development and Reform Commission, 'Top planner warns of overcapacity', *CD*, 21 September 2009; 'Official warns of overcapacity under industry recovery', *NCNA*, 3 December 2009.
22. *NCNA* covered the car manufacturers' resistance in some detail: Chen Bin, National Development and Reform Commission, 'Unchecked auto industry growth could harm China's economy: official', 4 September 2010; Chen Bin and Xu Changming, State Information Centre, 'China's auto makers reject "excess capacity" warning', 5 September 2010; 'China's auto industry not overheated, industry analysts argue', 17 October 2010. The campaign to rein in the industry switched from economic issues (where the industry's data were persuasive) to highlighting pollution and road congestion (complaints which were harder for the industry to counter), e.g., Liu Shijin, State Council Development Research Centre Deputy Director, 'Chinese think tank calls for refocus of auto industry development', *NCNA*, 23 October 2010. Overcapacity in this industry was a long-standing preoccupation of state planners, e.g., 'New moves to steer China's car sector stability', *PD*, 31 May 2006.
23. Even in a frank analysis of the problems ahead, for example, past progress was presented as almost spontaneous: 'More than ten years of reform efforts have resulted in three fundamental changes in the Chinese economy. The first change is the shift from shortage to surplus in the goods market. The second change is the successful transition from a centrally planned system to a market-base system. The third change is the opening of the economy to the rest of the world. All these achievements are attributable to the operation of a socialist market economy with Chinese characteristics'. Dai Xianglong, PBOC Governor, 'China's Financial Industry at the Threshold of the 21st Century', address at Stanford University (17 October 2000).
24. Liu Mingkang, CBRC Chairman, *2008 Annual Report*, p. 8.
25. Significantly, an excellent overview of reform debates during the first decade of reform has no discussion of either banking or financial issues although it has brief mentions of controversies about the importation of 'foreign capital'. Robert C. Hsu, *Economic Theories in China, 1979–88* (Cambridge: Cambridge University Press, 1991), pp. 26, 134–6, 139.
26. Dai, 'China's Financial Industry at the Threshold of the 21st Century'.
27. Zhou, 'Reform of the internal control and internal incentive systems of the commercial banks'.
28. 'Though Chinese law prohibited local governments from raising capital through bond issues, the central government was considering allowing "local governments raise funds by loan transfers or through appropriate channels or measures with central approval"'. Mu Hong, National Development and Reform Commission Vice Director, *NCNA*, 14 November 2008.
29. Zhou, 'Instability and Evolution of the Financial System', pp. 6–7.

30. 'The fact that the report, known as an Article IV review, was released at all marks an improvement in the sometimes-testy relationship between China and the Fund. China had blocked the IMF from publishing a review since 2006. The dispute was only resolved when the IMF backed away from calling China's currency "fundamentally misaligned," and substituted the term "substantially undervalued."' Andrew Batson, *Wall Street Journal*, 30 July 2010. Against this background, Zhou's special endorsement of the IMF's 'Article IV Consultations' has added interest.
31. Gore, 'The Communist Legacy in Post-Mao Economic Growth', pp. 36–8.
32. This state of affairs persisted until 2007, according to Shimin Chen, Zheng Sun, Song Tang and Donghui Wu, 'Government intervention and investment efficiency: Evidence from China', *Journal of Corporate Finance* (2010), p. 12 (doi:10.1016/j.jcorpfin.2010.08.004).
33. Zhou, 'Instability and Evolution of the Financial System', pp. 2–3.
34. Zhou Xiaochuan, PBOC Governor, 'Some Issues Concerning the Reform of the State-owned Commercial Banks', speech at the IIF Spring Membership Conference, Shanghai (16 April 2004).
35. *ibid.*
36. The official view, however, was that the level of corruption and malpractice depended very much on the success or otherwise of reforms to financial regulation and corporate governance. White Paper, *China's Efforts to Combat Corruption and Build a Clean Government* (Beijing: State Council Information Office, 2010), chapter v, 'Prevention of Corruption through System Reform and Institutional Innovation'.
37. Zheng Xinli, Party Policy and Research Office Deputy Director, 'Senior official warns against graft in 4-trillion-yuan gov't-funded projects', *NCNA*, 29 November 2008.
38. A typical denunciation of such misconduct in the pre-reform era was Xia Liji, 'Monetary transactions and the current class struggle', *PD*, 16 June 1975 (originally published in *Hongqi*, No. 6 (June 1975)).
39. An impressive analysis of this process can be found in Melanie Manion, *Corruption by Design: Building Clean Government in Mainland China and Hong Kong* (Cambridge, Mass.: Harvard University Press, 2004), especially pp. 97–101.
40. *ibid.*
41. Xiaoqiang Cheng and Patrick Van Cayseele, 'State Aid and Competition in Banking: The Case of China in the Late Nineties', *LICOS Discussion Paper 250/2009*, pp. 3–4, 7.
42. Feyzioglu, 'Does Good Financial Performance Mean Good Financial Intermediation in China?', *IMF Working Paper WP/09/170*, pp. 16, 17, 19–20, 22–4.
43. Shijun Zhao, Yue Ma, Yak-yeow Kueh, Shu-ki Tsang, Matthew S. Yiu, and Shucheng Liu, 'Banking Deregulation and Macroeconomic Impact in China: A Theoretical Analysis and Implications of WTO Accession to the Mainland and Hong Kong', *HKIMR Working Paper No.8/2002* (April 2002), pp. 1, 32.
44. Zhou, 'Improve Legal System and Financial Ecology', pp. 8–9.

45. The account of the Maoist era that follows, together with the quotations, is based on the analysis published in the early reform period by a well-known liberal economist from the State Council's Development Research Centre. Yang Peixin, 'Banking', in Yu Guangyuan (ed.), *China's Socialist Modernization* (Beijing: Foreign Languages Press, 1984), pp. 409–13, 414–20 in particular.
46. Typical 1975 examples were reported in provincial radio services: Guizhou, 23 December 1975; Liaoning, 8 June 1975; Hupei, 15 July 1975.
47. Commentator, 'The Construction Bank must guard the passes well', *PD*, 4 July 1978.
48. Li was to become Vice Chairman of the Financial and Economic Commission set up later in 1979. The other four headed the State Planning, State Economic, State Capital Construction and State Agricultural Commissions.
49. This summary of the conference is based on the report in *NCNA*, 8 March 1979.
50. *NCNA*, 1 November 1980.
51. For examples of these initiatives, see Leo Goodstadt, 'Banking on Change', *Asiabanking*, June 1986, p. 28.
52. Hou Yunchun, 'Improve regional cooperation by making the best use of local conditions and retaining advantages while eliminating disadvantages', *PD*, 2 August 1985.
53. A People's Bank official was quoted as expressing doubt about whether the technical resources could be found for a national cheque service even for business enterprises. *CD*, 30 October 1984.
54. The best overview of this phenomenon is Yasheng Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State* (Cambridge: Cambridge University Press, 2008), pp. 138–9, 144–5, 147–50.
55. Joseph Fewsmith, *Dilemmas of Reform in China: Political Conflict and Economic Debate* (Armonk: M. E. Sharpe, 1994), p. 167.
56. An excellent summary of the early transition to modern banking is Nicholas R. Lardy, *China's Unfinished Economic Revolution* (Washington, DC: Brookings Institution Press, 1998), chapter 3.
57. Huang, *Capitalism with Chinese Characteristics: Entrepreneurship and the State*, p. 139.
58. See Audrey Donnithorne, *China's Economic System* (London: George Allen & Unwin Ltd, 1967), pp. 403, 406, 412, 418–24, 429.
59. A participant's account of the Chinese Communist Party's decision to adopt this slogan can be found in Ruan Ming, *Deng Xiaoping: Chronicle of an Empire* (Boulder: Westview Press, 1994), pp. 29–37.
60. Kristen Parris, 'The Rise of Private Business Interests', in Merle Goldman and Roderick MacFarquhar (eds.), *The Paradox of China's Post-Mao Reforms* (Cambridge, Mass.: Harvard University Press, 1999), pp. 262, 271–5.
61. Deng Xiaoping, *Fundamental Issues in Present-day China* (Beijing: Foreign Languages Press, 1987), pp. 55, 123. The data are from Joseph C. H. Chai, *China: Transition to a Market Economy* (Oxford: Clarendon Press, 1997), Table 10.7. 'Share of Non-State sector in the Chinese Economy, 1980–1994', p. 179.

62. 'The law approved by the national legislature in March after repeated revisions and unprecedented eight readings ... had met with doubts and opposition from people who argued private property should not be leveled with state property'. 'Landmark property law takes effect', *NCNA*, 1 October 2007.
63. In October 2008, the Party Central Committee agreed 'to allow farmers to "lease their contracted farmland or transfer their land use rights" [to third parties] to boost the scale of operation for farm production and provide funds to start new businesses'. 'Chronology of the CPC's decision on rural reform, development', *NCNA*, 20 October 2008.
64. Liao Jili, 'The relationship between structural reform and horizontal and vertical integration', *PD*, 26 August 1980.
65. Hsu, *Economic Theories in China. 1979–88*, pp. 33–4.
66. Significantly, as late as 1996, the need for legislative and regulatory measures was not recognised in an otherwise probing Asian Development Bank review of banking developments. Christine P. W. Wong, 'Part One: People's Republic of China', in Pradumna B. Rana and Naved Hamid (eds.), *From Centrally Planned to Market Economies: The Asian Approach*, Vol. 2 (Hong Kong: Oxford University Press, 1996), pp. 175–80.
67. An excellent summary of the rural struggles can be found in Kate Xiao Zhou, *How the Farmers Changed China: Power of the People* (Boulder: Westview Press, 1996), pp. 60–71.
68. Indeed, the growth of the private sector created new opportunities for officials to exercise authority 'because they were still in control of essential economic elements (capital goods, financial capital, land and information)', and they frequently competed to profit from these powers both institutionally and personally. Eun Kyung Choi and Kate Xiao Zhou, 'Entrepreneurs and Politics in the Chinese Transitional Economy: Political Connections and Rent-seeking', *China Review*, Vol. 1, No. 1 (Fall 2001), p. 123.
69. For a review of the obstacles to reforms in the 1990s, see Jun Ma, *The Chinese Economy in the 1990s* (Basingstoke: Macmillan Press Ltd, 2000), pp. 69–71. On the perverse consequences for the banks of reforms in other parts of the system, see Susan L. Shirk, *The Political Logic of Economic Reform in China* (Berkeley: University of California Press, 1993), pp. 184, 217.
70. 'Full text of Chinese Vice President Xi Jinping's speech at World Investment Forum 2010', *NCNA*, 7 September 2010.
71. Wu Xiaoling, PBOC Deputy Governor, 'Strengthen China's Financial Industry in the Process of Opening up' (14 February 2006), pp. 3, 4.
72. Song Jingli, 'Foreign banks' assets share in China slides again', *CD*, 6 April 2010. The CBRC listed 84 foreign banks as operating in China in 2010 (URL: <http://www.cbrc.gov.cn/chinese/home/jsp/docView.jsp?docID=2045>).
73. A typical summary of the Chinese approach to development finance in the era before the 'open door' policies can be found in *NCNA*, 23 September 1974.
74. *NCNA*, 6 September 1976.
75. The Russians' transgressions included a welcome for American consumerism symbolised by approval for Pepsi Cola to start Russian factories, see *NCNA*, 16 September 1976. Pepsi started operations in China in 1982 but 20

- years later confessed that it had always operated at a loss despite investing a total of US\$500 million in its Chinese business. Peter Thompson, Pepsi International Group President, *PD*, 9 April 2002.
76. The classic account of the long battle by key Chinese Communist Party leaders to make full use of international trade and finance to accelerate China's modernisation and of their final triumph through Deng Xiaoping's 1978 initiatives is Lawrence C. Reardon, *The Reluctant Dragon: Crisis Cycles in Chinese Economic Policy* (Hong Kong: Hong Kong University Press, 2002), pp. 160–65, 169–70, 185–202 in particular.
 77. *Financial Times*, 30 June 1978.
 78. Tianjin city radio service, 28 November 1978.
 79. Leo Goodstadt, 'China's glad farewell to behind-schedule socialism', *Euromoney*, January 1977, p. 87.
 80. For a review of contemporary Chinese discussions of the ideological and technical obstacles to expanding foreign trade and banking in the 1970s, see Leo F. Goodstadt, 'China's Foreign Debts', *International Currency Review*, Vol. 10, No. 2 (May 1978), pp. 56–8, in particular.
 81. This account is from Wu, 'Strengthen China's Financial Industry in the Process of Opening up', pp. 1, 2.
 82. *NCNA*, 4 February 1981.
 83. These complications were very evident, for example, in what was regarded as a path-breaking refinery deal first proposed in 1978 and only completed in 1981. Leo Goodstadt, 'Yan Shan's long trek for funds ends at Amex', *Asian Banking*, November 1981, pp. 66–71. Its promoter was later punished for corruption. Shao-Chuan Leng and Hungdah Chiu, *Criminal Justice in Post-Mao China: Analysis and Documents* (Albany: State University of New York Press, 1985), p. 140.
 84. Leo Goodstadt, 'Lending to China: A spread of ½% may sound better in Chinese', *Euromoney*, May 1980, pp. 76–80. The obstacles persisted. Leo Goodstadt, 'It's Tough Getting over the Wall', *Euromoney*, April 1986, pp. 36–41.
 85. Yan Guangguo, 'Shanghai faces multiple problems while opening up to the outside world', *Shijie Jingji Daobao*, 6 January 1986.
 86. The vulnerability of the private sector generally to such behaviour is summarised in Charles J. P. Chen, Zengquan Li, Xijia Su and Zheng Sun, 'Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence', *Journal of Corporate Finance* (2010), p. 3 (doi:10.1016/j.jcorpfin.2010.09.009).
 87. This discrimination and the weight given to the objective creditworthiness of the borrower are analysed in Michael Firth, Chen Lin, Ping Liu and Sonia M. L. Wong, 'Inside the black box: Bank credit allocation in China's private sector', *Journal of Banking & Finance*, Vol. 33, Issue 6 (June 2009), pp. 1144–55.
 88. An instructive case study of the complex political environment which even Hong Kong manufacturers faced in Guangdong province can be found in Leslie Yip Sai-Ching and G. P. Walters, 'Wah Hoi Industrial Company', *Entrepreneurship: Theory and Practice*, Vol. 22, No. 3 (1998), pp. 87–99.

89. This survival was facilitated by the fact that the cultural values encouraged by the founding fathers of modern Chinese banking before 1949 and the start of the Chinese Communist Party's rule were 'superficially ... not incompatible with aspects of Communist indoctrination'. Andrea MacElderry, 'Confucian Capitalism? Corporate Values in Republican Banking', *Modern China*, Vol. 12, No. 3 (July 1986), p. 415. A concrete example of the cultural 'inheritance' is provided by Wen-Hsin Yeh, 'Corporate Space, Communal Time: Everyday Life in China's Bank of China', *American Historical Review*, Vol. 100, No. 1 (February 1995), p. 99.
90. Special Correspondent, 'China's overseas banks' deposits exceed \$3 billion', *Ta Kung Pao*, 6 March 1981.
91. Zhiu Xiao, *Zhongguo Xinwen She*, 16 November 1985.
92. 'The problem of the aging of our cadres' was regarded as a major challenge not just for banking but also for all levels of the Party and state leadership as the reform era got underway. Ren Tao, State Council Economic Research Centre, 'Consistency in Policies', in Su Wenning (ed.), *Modernization — the Chinese Way* (Beijing: Beijing Review, 1983), pp. 118–20.
93. Cai Esheng, PBOC Assistant Governor, 'Financial supervision in China: framework, methods and current issues', paper presented in the Joint BIS/PBC Conference: 'Strengthening the banking system in China: issues and experience', *BIS Policy Papers No. 7* (October 1999), pp. 167–72.
94. The NCNA reported, for example, the arrival of visiting bankers from the Australian Reserve Bank (17 April 1974), Bank of Tokyo (10 August 1974) and Austria (27 April 1975); while the Bank of China visited Canada (NCNA, 26 April 1976). For an extreme example of past political risks, see Samejima, *Nihon Kezai Shinbun*, 7 January 1967.
95. Leo F. Goodstadt, *Profits, Politics and Panics: Hong Kong's Banks and the Making of a Miracle Economy, 1935–1985* (Hong Kong: Hong Kong University Press, 2007), p. 94.
96. Damian Tobin, 'Austerity and Moral Compromise: Lessons from the Development of China's Banking System', *World Development* (2010), p. 10 (doi:10.1016/j.worlddev.2010.10.002).
97. On Hong Kong's standing with the Mainland, see the analysis by Charles Li, HKEx Chief Executive, 'Six Questions Regarding the Internationalisation of the Renminbi' (21 September 2010) (URL: <http://www.hkex.com.hk/eng/newsconsul/speech/2010/sp100920.htm>).

Chapter 4

1. Wang Chen, State Council Information Office Director, 'China registers historic progress in human rights', NCNA, 9 December 2008.
2. But note a contrary opinion: 'Beijing certainly does not want to place its [financial] bet only on Hong Kong, especially in light of the facts that Hong Kong is an economy that is de facto independent from and "foreign" to China, and that Hong Kong's political future remains unclear in light of expected full universal suffrage after 2017'. JiangYu Wang, 'Regulatory competition and cooperation between securities markets in Hong Kong and Mainland China', *Capital Markets Law Journal*, Vol. 4, No. 3 (July 2009), p. 389. This assertion seems to assume that China's leaders mistrust their

- own Basic Law which incorporates the preservation of an entirely separate, capitalist economy in Hong Kong in addition to the pledge of universal suffrage.
3. Hong Kong as a special case of colonial autonomy because of its dependence on China is discussed in Leo F. Goodstadt, 'Fiscal Freedom and the Making of Hong Kong's Capitalist Society', *China Information*, Vol. 24, No. 3 (November 2010), pp. 273–94.
 4. Gerard Caprio and Patrick Honohan, 'Restoring Banking Stability: Beyond Supervised Capital Requirements', *Journal of Economic Perspectives*, Vol. 13, No. 4 (Autumn 1999), pp. 49–50.
 5. Y. K. Mo 'A review of recent banking reforms in China', paper presented in Joint BIS/PBC Conference: 'Strengthening the banking system in China: issues and experience', *BIS Policy Papers No. 7* (October 1999), pp. 99–100.
 6. People's Bank of China, *China Financial Outlook 2000* (n.d., n.p.), pp. 19, 25.
 7. An illustration of this culture clash was recorded in Leo Goodstadt, 'The Hotel with Five Red Stars', *Euromoney*, February 1984, pp. 14–5.
 8. Leo Goodstadt, 'How safe is your China contract?', *Insight*, June 1979, p. 9.
 9. See Markus Taube, 'Economic Relations between the PRC and the States of Europe', *China Quarterly*, No. 169 (March 2002), p. 103.
 10. *Financial Times*, 28 January and 22 April 1999.
 11. For a good contemporary overview of the ITICs affair and its business and banking ramifications, see Faith Keenan, 'Finance: Picking up The Pieces', *Far Eastern Economic Review*, 6 May 1999.
 12. Prime Minister Zhu Rongji stated: 'If Chinese companies cannot afford to pay their debts, they must apply to the People's Bank of China and court to be made bankrupt ... The Chinese Government will protect the rights and interests of foreign creditors according to the law'. *CD*, 17 October 2000.
 13. Bloomberg News, *International Herald Tribune*, 8 August 2000; Xiao Xu, *CD*, 20 October 2001; Xia Bin, Financial Institute of the Development and Research Centre, *PD*, 27 July 2004.
 14. Xiaoqiang Cheng and Patrick Van Cayseele, 'State Aid and Competition in Banking: The Case of China in the Late Nineties', *LICOS Discussion Paper 250/2009*, pp. 3–4.
 15. People's Bank of China, *China Financial Outlook 2000*, Table 1-3. 'Closed or Bankrupt Financial Institutions during 1997–1998', p. 19.
 16. Zhou Xiaochuan, PBOC Governor, 'Some Issues Concerning the Reform of the State-owned Commercial Banks', speech at the IIF Spring Membership Conference, Shanghai (16 April 2004).
 17. Zhou Xiaochuan, PBOC Governor, 'Improve Legal System and Financial Ecology', speech at the 'Forum of 50 Chinese Economists' (2 December 2004), pp. 1–3.
 18. The regulatory developments are summarised in Hui Huang, 'Institutional structure of financial regulation in China: Lessons from the global financial crisis', *Journal of Corporate Law Studies*, Vol. 10, Part 1 (April 2010), pp. 222–3.
 19. Wu Xiaoling, PBOC Deputy Governor, Remarks on the International Seminar on the Tenth Anniversary of the Asian Financial Crisis (21 June 2007), pp. 3–5.

20. IMF, *People's Republic of China Staff Report for the 2010 Article IV Consultation* (9 July 2010), p. 16.
21. The press conference and his remarks were reported in 'Top official: Severe challenge for China to stop slowdown in economic growth', *NCNA*, 14 November 2008.
22. IMF, *People's Republic of China Staff Report for the 2010 Article IV Consultation*, p. 15.
23. A National Audit Office study of land sales in 11 cities between 2004 and 2006 discovered that they had evaded reporting 70 per cent of their net proceeds from land sales (equivalent to US\$12.52 billion). 'NAO says violations found in land proceeds management, land sales in 11 cities', *NCNA*, 4 June 2008. Details of subsequent violations were reported in National Audit Office, 'No. 6 Announcement of 2010: Audit Investigation Findings on Collection, Application and Management of Special Funds Earmarked for Land and Requisition and Transfer of Land in 40 Municipalities, Regions and Prefectures and 56 Counties and Districts under Their Jurisdiction', *Audit Reports* (17 September 2010) (URL: http://www.cnao.gov.cn/main/articleshow_ArtID_1092.htm).
24. Illegal holdings worth US\$1.8 billion were seized within a year. 'China increases reward for tipsters of unauthorized departmental coffers', *NCNA*, 25 August 2010.
25. 'China to monitor possible mass layoffs, large-scale labor disputes', *NCNA*, 18 November 2008.
26. This financial programme launched by the Guangzhou Development District was not as widely publicised as Dongguan's initiative. 'China to inject 30 billion yuan into major economic development district', *NCNA*, 12 December 2008.
27. Xie Liqun, Zhejiang Provincial Audit Department Director, 'Local government debts detrimental to state treasury: Chinese legislator', *PD*, 12 March 2005.
28. IMF, *People's Republic of China Staff Report for the 2010 Article IV Consultation*, p. 27.
29. Era Dabla-Norris, 'Issues in Intergovernmental Fiscal Relations in China', *IMF Working Paper WP/05/30* (February 2005), p. 15.
30. 'Chinese gov't investigating rural authority debts', *NCNA*, 28 November 2006.
31. These were issued in the form of 'book-entry national treasury bonds tradable ... on the inter-bank market and securities exchanges'. 'Local bonds of Liaoning, Tianjin set for sale', *PD*, 14 April 2009; '9b yuan Sichuan province local bond sale to open on Wed.', *NCNA*, 8 April 2009; 'China to sell local gov't bonds next week', *NCNA*, 18 June 2010.
32. Jing Ji, 'Local govts may be allowed to issue bonds', *CD*, 23 October 2008.
33. National Development and Reform Commission, 'NDRC to review status of stimulus driven projects', *CD*, 18 September 2010.
34. IMF, *People's Republic of China Staff Report for the 2010 Article IV Consultation*, p. 15.
35. *Ibid.*, pp. 15, 16, 27.

36. 'China's local gov'ts 3 trillion yuan in red with infrastructure, stimulus spending', *NCNA*, 23 June 2010.
37. Wang Bo, 'Regulator sees no risks from local govt loans', *CD*, 28 July 2010; "'No systemic risk" for local borrowings', *CD*, 20 August 2010.
38. For example, market nervousness about the China Construction Bank's exposure. 'CCB downplays default risks', *CD*, 24 August 2010.
39. Hu Xiaolian, PBOC Deputy Governor, Speech at the Symposium on Judicial Interpretation of Law on Real Rights (31 May 2010).
40. IMF, *People's Republic of China Staff Report for the 2010 Article IV Consultation*, p. 26.
41. Xiang Junbo, PBOC Deputy Governor, 'Improve the Legal System to Prevent Financial Risks', speech at the '2005 High-level Forum of China's Financial Reform' (26 April 2005), pp. 3, 6.
42. Hao Mingjin, Vice Minister of Supervision, 'Land, construction management "high-risk" posts for official corruption: watchdog', *NCNA*, 29 May 2010.
43. 'Backgrounder: A timeline of China's recent economic-stimulus measures', *NCNA*, 9 October 2008; 'China property stimulus plan targets low-income housing ownership', *NCNA*, 17 December 2008.
44. Xiao Gang, Bank of China Chairman, 'Top Chinese banker warns of lending risks', *NCNA*, 9 November 2009.
45. The negative consequences were reported in some detail for an international audience by *CD*: e.g., Wang Zhuoqiong, 'Officials punished for misuse of funds', 16 October 2009; Hao Yan, 'Local govts "want land sales" to pay back loans', 23 June 2010; 'Proceed cautiously on land-based funds', 13 October 2009.
46. 'China's local governments land sale revenue close to 233 bln. USD in 2009 on property mkt. surge', *NCNA*, 2 February 2010.
47. For a theoretical discussion of this issue, see Guillermo Rosas, 'Bagehot or Bailout? An Analysis of Government Responses to Banking Crises', *American Journal of Political Science*, Vol. 50, No. 1 (January 2006), pp. 186, 188.
48. Liu Mingkang, CBRC Chairman, 'Chinese Bankers Carry Hopes for Future Balances', speech delivered in Hong Kong (20 January 2010).
49. 'China regulates local gov't financing companies', *NCNA*, 14 June 2010.
50. Liu Mingkang, CBRC Chairman, Address at the third economic and financial situation briefing of CBRC (20 July 2010); Wang, *CD*, 28 July 2010.
51. Jia Kang, Ministry of Finance Institute of Fiscal Science Research Director, 'China should be aware of local govt debt risks: Official', *NCNA*, 2 November 2010.
52. 'Banking regulator urges structural reforms', *NCNA*, 24 October 2010.
53. Liu Mingkang, CBRC Chairman, 'Six Things that Make Us Concern[ed]', Keynote Speech at the 16th International Conference on Banking Supervision, Singapore (23 September 2010).
54. White Paper, *China's Efforts to Combat Corruption and Build a Clean Government* (Beijing: State Council Information Office 2010), chapter v, 'Prevention of Corruption through System Reform and Institutional Innovation'.
55. Xiao Gang, BoC Chairman, 'Liberalize interest rates further', *CD*, 7 January 2011. Such reforms had long been promised, however. See, for example,

- 'China's state-owned commercial banks to enjoy greater autonomy this year', *Zhongguo Xinwen She*, 25 March 1996.
56. The justification for such protectionist measures included a desire to safeguard Chinese depositors and defend the financial system against imported instability as the nation's banking system was opened up to the outside world. 'Overseas bankers raise concerns', *PD*, 24 August 2006.
 57. The agreement was never finalised because Guangdong officials were heavily involved in smuggling activities and thus profited from the new tariffs. Norman Miners, *Hong Kong Under Imperial Rule, 1912–1941* (Hong Kong: Oxford University Press, 1987), pp. 21–2.
 58. Treaty Series No. 9 (1949), *Exchange of Notes ... for the Prevention of Smuggling between Hong Kong and Chinese Ports* (London: Cmd 7615/1949).
 59. *Report of the Commission ... to Enquire into the Causes and Effects of the Present Trade Recession ...* (Hong Kong: Noronha & Co., 1935), pp. 76–7, 79, 81, 89–90.
 60. A full account of the negotiations can be found in HKRS163-1-402/3, 'China Trade And Commerce — Aide Memoire re Closer Cooperation between China and Hong Kong in Connection with Trade and Exchange Control'. The stubborn defiance of London's wishes is recorded in HKRS170-1-307, 'Banking Legislation ...' and HKRS41-1-6691, 'Banking Operations Legislation for Control of ...'.
 61. Commander in Chief Hong Kong telegram to War Office, 1 November 1945 (HKRS169-2-53, 'Rehabilitation of Business'); War Office secret telegram to Commander in Chief Hong Kong, no. 522263 F5, 22 March 1946 (HKRS169-2-26, 'Currency and Banking'); Officer Administering the Government telegram to Secretary of State for the Colonies, no. 958, 6 June 1947; S (later Sir Sidney) Caine (Colonial Office) telegram to D. M. MacDougall (Hong Kong), no. 982, 21 June 1947 (HKRS163-1-442, 'Import and Exchange Control in Hong Kong Proposed Visit of a H.K. Govt. Officer to the U.K. in Connection with ...'). Zhong-ping Feng, *The British Government's China Policy 1945–1950* (Keele: Ryburn Publishing, 1994), pp. 34–6.
 62. Cai Beihua, Shanghai Municipal People's Congress, 'Expectations for developing economic relations with Hong Kong', *Shehui Kexue*, No. 7 (15 July 1988), pp. 11, 12.
 63. An impressive analysis of Hong Kong's role in the pre-reform period and its political as well as its economic complexity is provided by Catherine R. Schenk, 'Banking and Exchange Rate Relations between Hong Kong and Mainland China in Historical Perspective: 1965–75', in Catherine R. Schenk (ed.), *Hong Kong SAR's Monetary and Exchange Rate Challenges: Historical Perspectives* (Basingstoke: Palgrave Macmillan, 2009).
 64. Lawrence C. Reardon, *The Reluctant Dragon: Crisis Cycles in Chinese Economic Policy* (Hong Kong: Hong Kong University Press, 2002), pp. 160–1.
 65. For example, Qu Shunping, 'Policy Measures for the Utilisation of Foreign Capital in Guangdong', *Guoji Maoyi Wenti*, No. 1 (January–February 1986), pp. 5–11; Feng Bangyan, 'The Role of Hong Kong in China's Modernisation Process', *Jingji Yanjiu*, No. 4 (20 April 1989), pp. 64–5

66. Yao Yufang, Li Fuqiang and Wang Haiyan, 'China's Regional Economic Development: The Factor Analytic Approach', in Roger C. K. Chan, Tientung Hsueh and Chiu-ming Lok (eds.), *China's Regional Economic Development* (Hong Kong: Hong Kong Institute of Asia-Pacific Studies, 1996), Table 4. 'Composite factor scores of per capita economic development levels by provinces, 1952–1989', p. 162.
67. Yang Qinquan and Jiang Zhiyuan, Guangzhou Party Propaganda Department, 'Analysis of the results of Guangzhou's foreign economic cooperation and future strategy', *Guangzhou Yanjiu*, No. 5 (September–October 1985), pp. 35–7.
68. In 1992 the Exchange Fund Ordinance (cap. 66) was amended through the addition of s. (1A) to give the Financial Secretary sweeping powers to maintain Hong Kong as an international financial centre. Under article 109 of the post-1997 Basic Law, 'the Government of the Hong Kong Special Administrative Region shall provide an appropriate economic and legal environment for the maintenance of the status of Hong Kong as an international financial centre'.
69. Douglas W. Arner et al., 'The Global Financial Crisis and the Future of Financial Regulation in Hong Kong', *AIFL Working Paper No. 4* (February 2009), p. 87.
70. Xu Dixin, 'On Hong Kong's economic relations with the Chinese Mainland', *Liaowang* (Overseas edition), No. 1 (16 September 1985), pp. 22–3.
71. Katherina Pistor, 'Banking Reform in the Chinese Mirror', *Columbia Law and Economics Working Paper No. 354* (10 August 2009), p. 2.
72. Henry Tang, Financial Secretary, *GIS*, 15 October 2005.
73. Wang, 'Regulatory competition and cooperation between securities markets in Hong Kong and Mainland China', *Capital Markets Law Journal*, p. 396.
74. 'Agricultural Bank's IPO: Agricultural revolution', *Economist*, 8 July 2010; Peter Stein, 'AgBank Prospectus Highlights Reasons for Caution', *Wall Street Journal*, 6 June 2010.
75. 'Mideast sovereign funds eye Agricultural Bank IP', *NCNA*, 1 June 2010; Jamil Anderlini, 'Fundraisings cast shadow on Agricultural IPO', *Financial Times*, 2 June 2010.
76. 'Agricultural Bank of China: Listing or capsizing?', *Economist*, 13 June 2010.
77. Pistor, 'Banking Reform in the Chinese Mirror', *Columbia Law and Economics Working Paper No. 354*, p. 20.
78. This change in attitude was not easy to admit. In 2010, RBS publicly expressed regret at having sold off its share holding in Bank of China. But RBS presented a very different assessment of its Mainland prospects barely a month later when it announced the decision to give away its retail operations in China to a Singapore Bank (DBS) for nothing. Naomi Rovnick and Lulu Chen, 'RBS chief regrets sale of 4.3pc stake in Bank of China', *South China Morning Post*, 10 November 2010; Zhou Yan, 'From Scotland to Singapore', *CD*, 16 December 2010.
79. Jonathan Anderson, 'The Great Chinese Bank Sale', *Far Eastern Economic Review*, September 2005, p. 12. However, while Chinese regulators have played down the fundraising role of these IPOs, they admit that 'the introduction

- of foreign strategic investment was initially a pure capital investment'. Liu Mingkang, CBRC Chairman, *2008 Annual Report*, p. 9.
80. The chapter 'Getting credit' in the 2006 survey began with China's deficiencies. The same chapter four years on did not report substantial improvements. World Bank, *Doing Business in 2006: Creating Jobs* (Washington, DC: World Bank, 2006); *Doing Business 2010: Reforming through Difficult Times* (Washington, DC: World Bank, 2009).
 81. Wu Xiaoling, PBOC Deputy Governor, Remarks at the International Seminar on the Tenth Anniversary of the Asian Financial Crisis, p. 4.
 82. The China Banking Regulatory Commission's defences of the pricing were reported in *PD*: Liu Mingkang, Chairman, 6 December 2005; Tang Shuangning, Vice Chairman, 10 March 2006. Criticism had first been provoked by the pre-listing terms for foreigners in the flotation of the Bank of Communications, with a respected Hong Kong business daily expressing sympathy for Mainland investors and alleging favouritism for foreigners. *Hong Kong Economic Journal*, 7 December 2005.
 83. A useful overview of the special problems of company flotations in China is Bill B. Francis, Iftekhar Hasana and Xian Sun, 'Political connections and the process of going public: Evidence from China', *Journal of International Money and Finance*, Vol. 28, Issue 4 (June 2009), pp. 696–719.
 84. Only the Bank of Communications, not one of the 'big four' and an earlier transaction, was seriously mispriced. World Bank Beijing, *Quarterly Update* (May 2007), pp. 18–20 and Table 3. 'China: Selected IPOs 2005–7'. On listing strategy, see Zhou Xiaochuan, PBOC Governor, 'Exclusive Interview with the People's Daily', *PD*, 8 May 2005.
 85. This article offered an impressive summary of Hong Kong's banking relationship with the Mainland after the first five years of economic reforms. Yang Xin, 'Hong Kong's foreign banks energetically develop their China business', *Gang Ao Jingji*, No. 3 (25 March 1985), pp. 17–9.
 86. Feng Bangyan, 'Hong Kong's role and the process of China's modernisation', *Jingji Yanjiu*, p. 67.
 87. A detailed review of the legal and institutional relationship between the Hong Kong authorities and their Mainland counterparts is presented in Duncan Alford, 'The Influence of Hong Kong Banking Law on Banking Reform in the PRC', *East Asia Law Review*, Vol. 3, No. 1 (Summer 2008), especially pp. 35–6, 43–8.
 88. Liu Mingkang, CBRC Chairman, 'Chinese Bankers Carry Hopes for Future Balances'.
 89. Alford, 'The Influence of Hong Kong Banking Law on Banking Reform in the PRC', *East Asia Law Review*, p. 42.
 90. Joseph Yam, HKMA Chief Executive, 'Speech British Chamber of Commerce', *HKMA*, 20 October 2006.
 91. Prime Minister Zhou died in 1976 but his instructions were quoted the following year by Deputy Premier Li to defeat ideological hostility towards giving special economic priority to Hong Kong. Reardon, *The Reluctant Dragon: Crisis Cycles in Chinese Economic Policy*, pp. 79–83, 147, 182.
 92. 'Wen: Economy shows positive changes', *NCNA*, 11 April 2009.

Chapter 5

1. Andrew Whitfield, *Hong Kong, Empire and the Anglo-American Alliance at War, 1941–1945* (Basingstoke: Palgrave, 2001), p. 218.
2. See Henry Wai-chung Yeung, *Transnational Corporations and Business Networks. Hong Kong firms in the Asian Region* (London: Routledge, 1998), pp. 130, 206–7.
3. Gordon Redding, ‘Culture and Business in Hong Kong’, in Wang Gangwu and Wong Siu Lun (eds.), *Dynamic Hong Kong: Business & Culture* (Hong Kong: Centre of Asian Studies, 1997), p. 102.
4. W. F. Jenner, *The Tyranny of History. The Roots of China’s Crisis* (London: Penguin Books, 1992), p. 191.
5. Jose Viñals and Jonathan Fiechter, ‘The Making of Good Supervision: Learning to Say “No”’, *IMF Staff Position Note SPN/10/08* (18 May 2010), p. 5.
6. IMF, ‘IMF Executive Board Concludes 2008 Article IV Consultation Discussions with People’s Republic of China — Hong Kong Special Administrative Region’, *Public Information Notice (PIN) No. 08/145* (8 December 2008), pp. 2–3.
7. IMF, ‘Cross-Cutting Themes in Economies with Large Banking Systems’ (16 April 2010), p. 19.
8. Douglas W. Arner et al., ‘The Global Financial Crisis and the Future of Financial Regulation in Hong Kong’, *AIIFL Working Paper No. 4* (February 2009), pp. 32–3.
9. The data are from John C. Tsang, Financial Secretary, *GIS*, 20 May, 7 June, 23 July and 1 September 2010; Au King-chi, Permanent Secretary for Financial Services and the Treasury, *GIS*, 21 September 2010.
10. Dong He et al., ‘Hong Kong’s Financial Market Interactions with the US and Mainland China in Crisis and Tranquil Times’, *Hong Kong Monetary Authority Working Paper 10/2009* (16 June 2009). See also the overall conclusions from the research papers presented in Hans Genberg and Dong He (eds.), *Macroeconomic Linkages between Hong Kong and Mainland China* (Hong Kong: City University of Hong Kong Press, 2008).
11. Sir John Gieve, BofE Deputy Governor, ‘Seven lessons from the last three years’ (19 February 2009), p. 17. But another senior British regulator indicated that such quantitative restrictions were no longer suitable except for ‘emerging countries (e.g. Hong Kong and Singapore)’. Lord Turner, *The Turner Review: A regulatory response to the global banking crisis* (London: Financial Services Authority, March 2009), p. 70.
12. House of Commons Treasury Committee, *Banking Crisis: regulation and supervision, Fourteenth Report of Session 2008–09* (London: HMSO, HC 767, 21 July 2009), pp. 36–7. Significantly, a 2007 BIS study failed to test against Hong Kong’s experience the assumption that quantitative restrictions were ‘bound to be less effective in economies that have highly developed capital markets, or institutions outside the scope of regulation, and that are very open to cross-border capital flows’. Claudio E V Borio and Ilhyock Shim, ‘What can (macro-)prudential policy do to support monetary policy?’, *BIS Working Papers No 242* (December 2007), pp. 13, 17.

13. Stephen Knowles and Arlene Garces-Ozanne, 'Government Intervention and Economic Performance in East Asia', *Economic Development and Cultural Change*, Vol. 51, No. 2 (January 2003), pp. 451–77.
14. Charles K. Rowley and Nathanael Smith, *Economic Contractions in the United States: A Failure of Government* (Fairfax: The Locke Institute, 2009), pp. 55–6.
15. Milton Friedman, 'Hong Kong Wrong: What would Cowperthwaite say?', *Wall Street Journal*, 6 October 2006.
16. M. 4. Acting Director of Supplies, Commerce and Industry to Labour Officer, 31 July 1947 (HKRS163-1-305, 'Retail Price & Wages Index. Preparation of ... '); Acting Financial Secretary minute to Colonial Secretary, 25 April 1957 (HKRS163-1-634, 'Public Utilities Companies Proposed Control of the Charges and Dividends Levied by ... ').
17. Measurable family hardship caused by rising rents was not acute. But the public mood, Cowperthwaite intimated, demanded immediate statutory controls (*HH*, 26 September 1962, pp. 280–2) 'Completely new industries' were his actual words (*HH*, 30 March 1962, pp. 131–4 and 26 February 1964, p. 45).
18. Compare Cowperthwaite, *HH*, 30 March 1967, p. 251 and Haddon-Cave, *HH*, 5 January 1972, p. 318. There was no economic case for such loans. Industry Development Branch, 'The Case for Improved Access to Loans for Re-equipment Purposes by Small Scale Industry' (*Department of Commerce and Industry*, *IND 2/903*, 27 October 1969, mimeo) and 'Memorandum to the Loans for Small Industry Committee' (*Commerce and Industry Department*, *IND 2/903*, 4 November 1969, mimeo). The scheme failed and was wound up in 1976. H. C. Y. Ho, *The Fiscal System of Hong Kong* (London: Croom Helm, 1979), p. 62.
19. *Report of the Advisory Committee on Diversification 1979* (Hong Kong: Government Printer, 1979), p. 167; *HH*, 13 April 1978, p. 812.
20. This point was made in the Hong Kong context when the colonial administration was making a last stand against regulatory reforms in the middle of market collapses and a runaway money supply. A. J. Youngson, *Hong Kong's Economic Growth and Policy* (Hong Kong: Oxford University Press, 1982), p. 131.
21. Joseph Yam, HKMA Chief Executive, 'Towards a Stronger Financial System', speech to the Hong Kong Society of Accountants, *HKMA*, 29 October 1999. This presentation includes a lucid review of the case for more active regulation and intervention in a small open economy like Hong Kong.
22. The discussion in this paragraph reflects in particular the analysis presented in Joseph Yam, HKMA Chief Executive, 'Hong Kong and Asia: Strategies for Recovery', *Far Eastern Economic Review* Conference, *HKMA*, 16 June 1999 and 'Issues in Monetary Policy' Hong Kong University Speech, *HKMA*, 19 January 2004.
23. Of Hong Kong's total trade in financial services during 2008, the United States accounted for 34 per cent of exports and 22 per cent of imports, while the United Kingdom accounted for 23 per cent of exports and 17 per cent of imports. Census and Statistics Department, *Report on Hong Kong Trade in Services Statistics for 2008* (Hong Kong: Census and Statistics Department, 2010), pp. 36, 43.

24. Y. C. Jao, 'Hong Kong as a Financial Centre of China and the World', in Lok Sang Ho and Robert Ash (eds.), *China, Hong Kong and the World Economy. Studies in Globalization* (New York: Palgrave Macmillan, 2006), pp. 123–4, 130, 132; Howard Curtis Reed, 'The Ascent of Tokyo as an International Financial Center', *Journal of International Business Studies*, Vol. 11, No. 3 (Winter 1980), Table 3. 'Rankings of Asian International Bank Centers', p. 28.
25. Significantly, the first HKMA Chief Executive quoted the latest comments of the Chairman of the United States Federal Reserve Board at some length when explaining why Hong Kong would follow a different course. Joseph Yam, HKMA Chief Executive, 'Viewpoint', *HKMA*, 19 March 2009.
26. K. Y. Yeung, Secretary for the Treasury, 'The Role of the Hong Kong Government in Industrial Development', in Edward K. Y. Chen et al. (eds.), *Industrial and Trade Development in Hong Kong* (Hong Kong: Centre of Asian Studies, 1991), p. 49.
27. As late as 1999, however, standards for the securities industry and corporate governance still fell short of international benchmarks. *A Policy Paper on Securities and Futures Markets Reform* (Hong Kong: HKSARG, 1999), pp. 16–9.
28. Neil Gunningham, 'Moving the Goalposts: Financial Market Regulation in Hong Kong and the Crash of October 1987', *Law & Social Inquiry*, Vol. 15, No. 1 (Winter, 1990), pp. 46, 53.
29. Donald Tsang Yam-kuen, Financial Secretary, *GIS*, 16 June 2000.
30. Charles Goodhart and Lu Dai, *Intervention to Save Hong Kong: Counter-Speculation in Financial Markets* (Oxford: Oxford University Press, 2003), pp. 2, 4.
31. Alan Greenspan, FRB Chairman, Testimony before the House of Representatives, Committee on Banking and Financial Services (16 September 1998), p. 310.
32. Donald Tsang, Financial Secretary, *GIS*, 23 September 1999.
33. IMF, *Concluding Statement for the Article IV Consultation with the People's Republic of China in respect of the Hong Kong Special Administrative Region* (30 October 1998).
34. Alkman Granitsas et al., 'Politics and the Peg: Hong Kong fends off speculators at the price of credibility', *Far Eastern Economic Review*, 27 August 1998.
35. Louise Lucas, 'Hong Kong: State defence of currency under attack', *Financial Times*, 29 August 1998.
36. Jame DiBiasio, 'Hong Kong's Cultural Revolution', *FinanceAsia* (September 2000), p. 28.
37. Edmund R. Thompson, 'Dangers of Differential Comprehensions of Hong Kong's Competitive Advantages: Evidence from Firms and Public Servants', *China Quarterly*, Vol. 167 (September 2001), p. 707.
38. Lord Turner, FSA Chairman in House of Commons Treasury Committee, *Banking Crisis*, Vol. I. Oral evidence (HMSO: HC 144–I, March 2009), p. EV280.
39. Alan Greenspan, *The Age of Turbulence: Adventures in a New World* (New York: Penguin Press, 2007), p. 371.

40. Dora Iakova, 'How Hong Kong SAR Banks Survived the Asian Crisis', in Jahangir Aziz, Jeanne Gobat, Dora Iakova, William Lee and Peter Breuer, *People's Republic of China — Hong Kong Special Administrative Region. Selected Issues and Statistical Appendix*, IMF Country Report No. 01/146 (August 2001), pp. 23–8. 'Good luck' got two 'headline' mentions (pp. 24, 29).
41. Scott Lanman, 'Greenspan Says Hong Kong's Yam Was Right to Buy Stocks in 1998', *Bloomberg*, 19 May 2009.
42. This acknowledgment was presented in an unflattering context, however. Paul Tucker, BoE Deputy Governor, Remarks at the Institute of International Bankers Annual Breakfast Regulatory Dialogue, Washington, DC (11 October 2010), p. 3.
43. For example, throughout the previous century, Hong Kong was dominated by international and Chinese Mainland banks, a fact which had not weakened its capacity to regulate them effectively. Yet, the IMF commented: 'The size of the banking sector needs to match the resources of the home regulator. The small fiscal resources of Hong Kong SAR and Singapore, the main Asian money centers, may have constrained the scale of banks they can credibly place under their supervisory umbrella'. (Emphasis in the original) IMF, 'Cross-Cutting Themes in Economies with Large Banking Systems', p. 23.
44. A. G. Hopkins, 'Back to the Future: From National History to Imperial History', *Past & Present*, No. 164 (August 1999), pp. 235, 238. The article does not suggest, however, that this phenomenon could occur in the contemporary world and specifically not in financial services.
45. This was the traditional view of British colonial economies. Ida Greaves, 'The Character of British Colonial Trade', *Journal of Political Economy*, Vol. 62, No. 1 (February 1954), pp. 3, 4–6.
46. Tang Shu-hung, 'The Economy', in Joseph Y. S. Cheng and Sonny S. H. Lo (eds.), *From Colony to SAR: Hong Kong's Challenges Ahead* (Hong Kong: Chinese University Press, 1995), p. 130.
47. Y. C. Richard Wong, 'Public Policies in the Hong Kong Economy: Emphasis on Manufacturing', in F. Gerard Adams and William E. James (eds.), *Public Policies in East Asian Development: Facing New Challenges* (Westport: Praeger Publishers, 1999), p. 146.
48. On the economists' hostility to government intervention to protect the exchange rate and the financial markets in 1998, see Y. C. Jao, *The Asian Financial Crisis and the Ordeal of Hong Kong* (Westport: Quorum Books, 2001), p. 87. They had succeeded in blocking government plans for an old age pension scheme in 1994. Francis T. Lui, *Retirement Protection: A Plan for Hong Kong* (Hong Kong: City University of Hong Kong Press, 1998), pp. 6–7.
49. The strength of this aversion to Keynes is not always recognised, and there is sometimes an assumption that Hong Kong officials will adopt much the same measures as governments elsewhere. See, for example, the assertion that 'high fiscal surpluses accumulated during the good times allowed the [Hong Kong] government to engage in countercyclical fiscal policy during the Asian crisis' (whereas, in reality, the government struggled hard to cut its spending). W. Max Corden, 'Exchange Rate Regimes for Emerging

- Market Economies: Lessons from Asia', *Annals*, Vol. 579 (January 2002), p. 33.
50. See H. W. Singer, 'The Distribution of Gains between Investing and Borrowing Countries', *American Economic Review*, Vol. 40, No. 2 (May 1950), p. 473; Hla Myint, 'Economic Theory and the Underdeveloped Countries', *Journal of Political Economy*, Vol. 73, No. 5 (October 1965), pp. 477–8.
 51. Sir Robert Black, Governor, letter to Sir Hilton Poynton (Colonial Office), 19 July 1958 (HKRS270-5-44, 'Commercial and Industrial Development — Major Policy'); Cowperthwaite, *HH*, 26 February 1964, p. 47; 24 February 1966, p. 57.
 52. In Hong Kong, he insisted, public finance could not seek to 'pursue social justice or to manipulate — or rather try to manipulate — the rate and pattern of economic growth'. Haddon-Cave, *HH*, 7 April 1976, p. 802. He seemed not to know that the 1964 Banking Ordinance included among its aims: 'to regulate such [banking] business for monetary policy purposes'.
 53. Tung Chee Hwa, Chief Executive, *GIS*, 10 August 2000.
 54. (79) Cowperthwaite letter to W. F. Searle, Chief Statistician (Colonial Office), 8 June 1955 (HKRS163-9-88, 'Trade — Balance of Payment Statistics. Policy Regarding Preparation of ...').
 55. For example, *HH*: Cowperthwaite, 27 February 1963, p. 41; 10 March 1966, p. 57; 8 October 1969, p. 85; Haddon-Cave, 28 March 1973, p. 645; 26 February 1975, p. 484, f.n. 53; 3 April 1975, p. 691, f.n. 4; and *GIS*, 1 February 1982.
 56. Tony Latter, 'Rules versus Discretion in Managing the Hong Kong dollar, 1983–2006', *HKIMR Working Paper No. 2/2007* (January 2007), p. 9.
 57. It should be noted that most Hong Kong academics assume the opposite. Financial policy is presented as a major instance of United Kingdom exploitation of the colonial relationship, in Alex H. Choi, 'State-Business Relations and Industrial Restructuring', in Tak-Wing Ngo (ed.), *Hong Kong's History. State and society under colonial rule* (London: Routledge, 1999), pp. 149–50.
 58. *Report of the Commission ... to Enquire into the Causes and Effects of the Present Trade Recession ...* (Hong Kong: Noronha & Co., 1935), pp. 82–3, 86.
 59. Sir Lesley Robinson (Board of Trade), (12) Minutes of the Sixth Meeting, 22 August 1961 (HKRS270-5-56, 'Cotton Advisory Board. Minutes of Meeting').
 60. Frank H. H. King, *The Hong Kong Bank in the Period of Development and Nationalism, 1941–1984. From Regional Bank to Multinational Group* (Cambridge: Cambridge University Press, 1991), pp. 345–6.
 61. Economic Secretary minute to Financial Secretary, 17 May 1952; (79) Cowperthwaite to Searle, 8 June 1955; (294) Cowperthwaite letter to Searle, 11 August 1959 (HKRS163-9-88).
 62. The best account of Hong Kong's struggle for financial autonomy is Catherine R. Schenk, 'The empire strikes back: Hong Kong and the decline of sterling', *Economic History Review*, Vol. LVII, No. 3 (August 2004), pp. 570–3.
 63. A confidential British Treasury statement said that it was 'inappropriate for [the United Kingdom government] to enter into specific commitments

- to provide assistance to Hong Kong' in a financial crisis. Alastair Mackay (British Treasury) letter to Financial Secretary, 22 July 1971 (HKRS163-9-217, '(A) Meeting of Senior Commonwealth Finance Officials 1970. Sterling Area Balance Of Payments — Developments and Prospects To Mid-1971 (B) Overseas Sterling Area Countries Statistics').
64. Gordon A. Hughes et al., 'Protection and Developing Countries' Exports of Manufactures', *Economic Policy*, Vol. 1, No. 2 (April 1986), pp. 412, 422; Matthew Turner, 'Hong Kong Design and the Roots of Sino-American Trade Disputes', *Annals*, Vol. 547 (September 1999), pp. 37–53.
 65. See the comments of Suzanne Berger and Richard K. Lester (eds.), *Made By Hong Kong* (Hong Kong: Oxford University Press, 1997), pp. 152, 163; GIS, 6 August 1997 and 9 August 1999; Chau Tak Hay, Secretary for Trade and Industry, *GIS*, 2 May 1998.
 66. Mark S. Gaylord, 'The Chinese Laundry: International Drug Trafficking and Hong Kong's Banking Industry', in Harold H. Traver and Mark S. Gaylord (eds.), *Drugs, Law and the State* (Hong Kong: Hong Kong University Press, 1992), p. 90. *GIS*, 4 July 1999; David Carse, HKMA Deputy Chief Executive, *GIS*, 15 September 1999.
 67. Examples of the scope of this campaign were reported in *Far Eastern Economic Review*. 'Hongkong Company Meetings', 20 May 1954 and Derek Davies, 'Hongkong Affairs: The Hong Kong Hilton', 4 July 1963. See also Richard I. Devane, 'The United States and China: Claims and Assets', *Asian Survey*, Vol. 18, No. 12 (December 1978); Chi-kwan Mark, 'American "China Hands" in the 1950s', in Cindy Yik-yi Chu (ed.), *Foreign Communities in Hong Kong, 1940s–1950s* (New York: Palgrave Macmillan, 2005), pp. 176–8, 181–4.
 68. Secretary of State for the Colonies savinggram to Officer Administering the Government, 'United States Investment Guarantee', 19 October 1965; (20) Financial Secretary note, 18 June 1966 (HKRS163-3-269, 'Investment Guarantees by the United States Government').
 69. For an example of Hong Kong's assertion of the right to disagree with London, see Bremridge, Financial Secretary, *HH*, 27 February 1985, p. 680.
 70. This point was made by an official who had served as commissioner of banking and also for securities. Robert Fell, *Crisis and Change. The Maturing of Hong Kong's Financial Markets* (Hong Kong: Longman, 1992), p. 150. It must also be noted that the legislation was based on recommendations by a Bank of England official whose services as an advisor had been sought by Hong Kong. See H. J. Tomkins, *Report on the Hong Kong Banking System and Recommendations for the Replacement of the Banking Ordinance 1948* (Hong Kong: Government Printer, 1962). Hong Kong officials, nevertheless, regarded themselves as the decision-makers.
 71. On the impact of the new banking model on Hong Kong and on regulatory challenges generally, see Y. C. Jao, 'The Rise of Hong Kong as a Financial Centre', *Asian Survey*, Vol. 19, No. 7 (July 1979), p. 688; Robert Z. Aliber, 'Financial Innovation and the Boundaries of Banking', *Managerial and Decision Economics*, Vol. 8, No. 1 (March 1987), pp. 67–9.
 72. Hong Kong's formal dialogue with the Chinese government on the continuity of the financial system began in May 1987 and continued throughout the

- next decade. Joseph Yam, HKMA Chief Executive, ‘Viewpoint’, *HKMA*, 3 May 2007.
73. Roger W. Ferguson, Jr., FRB Vice Chairman, ‘Financial Engineering and Financial Stability’, remarks at the Annual Conference on the Securities Industry, American Institute of Certified Public Accountants and the Financial Management Division of the Securities Industry Association, New York (20 November 2002).
 74. Ben S. Bernanke, FRB Chairman, ‘Financial Innovation and Consumer Protection’, speech at the Sixth Biennial Community Affairs Research Conference, Washington, DC (17 April 2009).
 75. HMG, *Reforming financial markets* (London: HMSO, Cm 7667/2009), p. 140.
 76. Cowperthwaite, *HH*, 8 October 1969, p. 85; Haddon-Cave, *HH*, 13 December 1972, pp. 218–29; 14 November 1974, p. 218.
 77. In an earlier passage, Cowperthwaite had declared: ‘The trouble is that economic analysis of future events is a matter, not of demonstrable fact, but of judgment and opinion ... Government should not in general interfere with the course of the economy merely on the strength of its own commercial judgment. If we cannot rely on the judgment of individual businessmen, taking their own risks, we have no future anyway’. *HH*, 24 March 1966, pp. 215, 216.
 78. Policy-makers had similar misgivings about the merits of unfettered competition in other markets, including export manufacturing. See (3) Director of Commerce and Industry (H. A. Angus) letter to Wilkinson and Grist, 25 July 1962 (HKRS163-1-2861, ‘Cotton Textiles Allocation of Quota to Restricted Markets’); *Hong Kong Report for the Year 1969* (Hong Kong: Government Press, 1970), p. 50.
 79. See Catherine R. Schenk, ‘The origins of Anti-competitive Regulation: Was Hong Kong “Over-banked” in the 1960s?’, *HKIMR Working Paper No. 9/2006* (July 2006), pp. 8–9, 11, 15.
 80. The change in attitude between Cowperthwaite and his predecessor as Financial Secretary is evident from a comparison of Circular No. 68, ‘Deutsch-Asiatische Bank,’ 10 December 1957, with Circular No. 95, ‘Banking Ordinance — chapter 155 Bank Negara Indonesia’, 16 June 1961 (HKRS 163-1-679, ‘Banking Advisory Committee’).
 81. Haddon-Cave, *HH*, 8 January 1975, pp. 340, 341–2; 15 March 1978, pp. 623–4.
 82. Fuller details of the regulatory problems of the decade can be found in Leo F. Goodstadt, ‘Dangerous Business Models: Bankers, Bureaucrats & Hong Kong’s Economic Transformation, 1948–86’, *HKIMR Working Paper No. 8/2006* (June 2006), pp. 15–21.
 83. His arguments against regulation also included the difficulties of enforcement in an open economy like Hong Kong. Bremridge, *HH*, 30 July 1975, pp. 948–51.
 84. Fell, *Crisis and Change*, p. 158; Leo Goodstadt, ‘Mum’s the Word’, *Asian Banking*, January 1983, p. 32. The criminal features of the financial scandals of this period are summarised in R. T. Naylor, *Hot Money and the Politics of Debt*, 3rd ed. (Montreal: McGill-Queen’s University Press, 2004), pp. 208–22.

85. Contemporary reporting of these events is recorded in Philip Bowring and Robert Cottrell, *The Carrian File* (Hong Kong: Far Eastern Economic Review Ltd, 1984).
86. Customer deposits with 241 DTCs were equivalent to 17 per cent of the total with licensed banks in 1978, 22 per cent in 1982, but only 10 per cent in 1987. Census and Statistics Department, *Hong Kong Annual Digest of Statistics*, 1988 ed. (Hong Kong: Census and Statistics Department, 1988), pp. 125–8.
87. T. K. Ghose, *The Banking System of Hong Kong* (Singapore: Butterworths, 1987), p. 96. The actual exposure of the Exchange Fund in supporting these banks was probably significantly larger at the height of the crisis.
88. Census and Statistics Department, *2003 Gross Domestic Product* (Hong Kong: Census and Statistics Department, 2004), p. 81.
89. Bremridge, *HH*, 19 March 1986, p. 771.
90. The Bank of England was castigated by a parliamentary inquiry for its over-emphasis on moral hazard during the first stage of the global financial crisis. This official report, nevertheless, remained true to this principle in its recommendations. House of Commons Treasury Committee, *The run on the Rock Fifth Report of Session 2007–08*, Vol. I (London: HMSO, HC56-I, January 2008), pp. 43, 77.
91. Thomas Huertas, FSA Banking Sector Director, ‘Competition in Banking: The Role of Orderly Entry and Orderly Exit’, speech at the Chatham House Conference, London (20 June 2008).
92. Lawrence Summers, ‘Beware moral hazard fundamentalists’, *Financial Times*, 23 September 2007.
93. This statement was made in the context of discussion among officials about whether the 1948 Banking Ordinance ought to be enforced with any diligence. See HKRS41-1-3044, ‘The Nam Sang Bank — 1. Application from ... for a Banking Licence. 2. Balance Sheet of ... 3. Cancellation of the Licence of ...’.
94. This view was regarded as racist nonsense by a leading expatriate businessman at the time. Colonial Treasurer memorandum, 25 August 1936; Patterson minute to Colonial Secretary, 31 August 1938 (HKRS170-1-307, ‘Banking Legislation — 1. General Supervision of Banking Concerns in Hong Kong ...’).
95. The pre-war allegation of Chinese indifference to bank failures was repeated two decades later: ‘The Government itself does not seem to have received complaints, direct or indirect, from depositors who have lost their money’. (86) Financial Secretary, 23 October 1959 (HKRS 163-1-679).
96. The one exception was the Hong Kong branch of the BCCI in 1991. Its local operations were solvent but it could not survive its overseas parent’s collapse. Its failure provoked brief runs on four other banks, including Standard Chartered, a note-issuer. See Michael Taylor, ‘Hongkong: Exchange of Views’, *Far Eastern Economic Review*, 17 October 1991.
97. Haddon-Cave, *HH*, 8 January 1975, pp. 342–3; F. W. Li, appointed member, *HH*, 15 November 1978, p. 172.
98. Y. C. Jao, ‘Monetary system and banking structure’, in H. C. Y. Ho and L. C. Chau (eds.), *The Economic System of Hong Kong* (Hong Kong: Asian Research Service, 1988), p. 59.

99. Albeit while he was still a businessman. Bremridge, *HH*, 30 July 1975, p. 949.
100. See Bremridge, *HH*, 9 April 1986, pp. 981–7.
101. A Commissioner for Securities writing in 1990, close to the ignominious collapse in 1987, was still anxiously lobbying for minimal regulation. Robert Owen, ‘Hong Kong Maintains Tradition of Light-Handed Regulation’, in Securities and Futures Commission, *Securities Regulation in Hong Kong* (Hong Kong: Securities and Futures Commission, 2002), pp. 71–2, 76.
102. Joseph Yam, HKMA Chief Executive, ‘Viewpoint’, *HKMA*, 18 October 2007.
103. The British view was that moral hazard should be preserved. House of Commons Treasury Committee, *The run on the Rock*, pp. 74, 77.
104. ‘There is a further argument for maintaining a degree of constructive ambiguity in order to avoid encouraging moral hazard by setting out too clearly the terms on which support might be forthcoming. This is a valid point. But it is also worth noting that the problem of moral hazard, while it can never be entirely eradicated, has been considerably reduced in Hong Kong in recent years’. Joseph Yam, HKMA Chief Executive, ‘The Lender of Last Resort’, speech to the Hong Kong Association of Banks, *HKMA*, 29 June 1999.
105. Yam, ‘Viewpoint’, *HKMA*, 18 October 2007.
106. Donald Tsang Yam-kuen, Financial Secretary, *GIS*, 12 June 1997. The research evidence showed that this nervousness was unjustified. See Guorong Jiang et al., ‘Banking Sector Competition in Hong Kong — Measurement and Evolution Over Time’, *Hong Kong Monetary Authority Research Memoranda* (20 April 2004). Note the continuing concern about competition expressed by Joseph Yam, HKMA Chief Executive, ‘View Point’, *HKMA*, 31 August 2006.
107. A persuasive account of why the Hong Kong Monetary Authority did not believe that financial markets could be left to find their own remedies for instability after the Asian financial crisis was presented in 1998 by the current HKMA Chief Executive. Norman Chan, HKMA Deputy Chief Executive, ‘The Asian Financial Crisis: What have we Learnt?’, speech to the Oxford University Asia-Pacific Affairs Society (7 June 1999).
108. KPMG and Barents Group LLC, *Hong Kong Banking into the New Millennium*, Hong Kong Banking Sector Consultancy Study (December 1998), Table 1.6.1. ‘Sector-level key success performance comparison’, pp. 9, 17; Table 1.10.1. ‘Proposed implementation approach for key recommendations’, p. 42; and Table 1.10.2. ‘High-level implementation plan — key regulatory and supervisory recommendations’, p. 43; HKMA, ‘Policy Response to the Banking Sector Consultancy Study’ (June 1999).
109. For an excellent summary of the Lehman mini-bonds, what they were, how they were marketed and why their failure provoked widespread criticism of the regulators, see Arner et al., ‘The Global Financial Crisis and the Future of Financial Regulation in Hong Kong’, *AIIFL Working Paper No. 4*, pp. 33 *et seq.*
110. The largest distributor of these securities was the Hong Kong arm of the Bank of China. For details of its involvement, see Fu Lei, ‘Banker goes to trial over minibonds’, *CD*, 26 November 2011.

111. On this feature of Hong Kong's political landscape, see Leo F. Goodstadt, *Uneasy Partners: The Conflict between Public Interest and Private Profit in Hong Kong*, 2nd ed. (Hong Kong: Hong Kong University Press, 2009), pp. xiv–xvi.
112. The evidence in support of this conclusion is based on research from the run-up to the crises of both 1930–33 and 2007–08. Thomas Philippon and Ariell Reshef, 'Wages and Human Capital in the U.S. Financial Industry: 1909–2006' (December 2008), p. 30 (URL: http://pages.stern.nyu.edu/~tphilipp/papers/pr_rev15.pdf). The impact of this paper is indicated by the attention it received from the *Economist*, for example: 'Paying the piper', 5 February 2009 and 'The coming recovery', 28 May 2009.
113. This resilience was particularly evident in the sustained growth of the export sector and the continuing (albeit lower) growth in real GDP in the 1960s despite a banking crisis and violent anti-colonial clashes. The pattern was repeated in the following decade (with the services sector coming to the fore) despite serious defects in regulatory performance and monetary management. For the data, see Census and Statistics Department, *Hong Kong Statistics 1947–1967* (Hong Kong: Government Printer, 1969), p. 88 and *2003 Gross Domestic Product* (Hong Kong: Census and Statistics Department, 2004), pp. 14–6, 20, 78–9.
114. Eric Wong, Tom Fong, Ka-fai Li and Henry Choi, 'An assessment of the long-term economic impact of the new regulatory reform on Hong Kong', *Hong Kong Monetary Authority Research Note 05/2010* (9 November 2010), p. 4 and repeated verbatim p. 9.
115. Joseph Yam, Chief Executive HKMA, 'The Political Process of Monetary Management', Hong Kong Management Association 13th Susan Yuen Memorial Lecture, *HKMA*, 20 October 1998.

Conclusions

1. Lord Turner, FSA Chairman, 'Something old and something new: Novel and familiar drivers of the latest crisis', speech to the European Association of Banking and Financial History, Brussels (21 May 2010).
2. Laura Kodres and Aditya Narain, 'Redesigning the Contours of the Future Financial System', *IMF Staff Position Note SPN/10/10* (16 August 2010), p. 4.
3. Andrew G. Haldane, BoE Executive Director, 'The Contribution of the Financial Sector: Miracle or Mirage?', speech at the Future of Finance Conference, London (14 July 2010), p. 2.
4. Before the global crash, China's central bankers were alarmed that the younger generation took stability for granted: 'The more likely norm is that a financial system faces instability or turbulences of varying degree every few years; freedom from all such instability would be, in fact, abnormal'. Zhou Xiaochuan, PBOC Governor, 'Instability and Evolution of the Financial System' (5 December 2007), p. 1. After the crash, the regulators' language became blunter: 'People in this business always have short memories'. Liu Mingkang, CBRC Chairman, 'Six Things that Make Us Concern[ed]', Keynote Speech at the 16th International Conference on Banking Supervision, Singapore (23 September 2010).

5. This point has been made forcibly in the context of the United States and the ‘Great Crash’. Gertrude Tumpel-Gugerell, European Central Bank Executive Board Member, ‘Business Models in Banking: Is There a Best Practice’, paper presented in the CAREFIN Conference, Milan (21 September 2009), pp. 2, 4, 5, 8.
6. This argument was presented very powerfully by Michael C. Jensen, ‘The Modern Industrial Revolution, Exit, and the Failure of Internal Control Systems’, *Journal of Finance*, Vol. 48, No. 3 (July 1993), pp. 864–6, 867–9.
7. Adrian Blundell-Wignall, Gert Wehinger and Patrick Slovik, ‘The Elephant in the Room: The Need to Deal with What Banks Do’, *OECD Journal: Financial Market Trends*, Vol. 2009, Issue 2, pp. 2, 10.
8. Gerard Caprio and Patrick Honohan, ‘Restoring Banking Stability: Beyond Supervised Capital Requirements’, *Journal of Economic Perspectives*, Vol. 13, No. 4 (Autumn 1999), p. 48.
9. Franklin Allen and Douglas Gale, ‘Competition and Financial Stability’, *Journal of Money, Credit and Banking*, Vol. 36, No. 3, Part 2 (June 2004), Table 1. ‘Average cumulative fiscal costs of banking crises in 24 crises, 1977–2000’ and Table 2. ‘Output losses associated with banking crises, 1977–98’, pp. 454–5.
10. This conclusion was based on a study of 60 countries for the period 1980–2002. Romain Ranciere, Aaron Tornell and Frank Westermann, ‘Decomposing the effects of financial liberalization: Crises vs. Growth’, *National Bureau of Economic Research Working Paper 12806* (December 2006), p. 16.
11. Haldane, ‘The Contribution of the Financial Sector: Miracle or Mirage?’, pp. 4–5. Haldane’s paper stands up very well to complaints from the Governor of the Bank of England that these sorts of estimates are misleading; have not been adjusted for the real costs of the risks involved in this industry; and over-estimate both its profits and its productivity. Mervyn King, BoF Governor, ‘Banking: From Bagehot to Basel, and Back Again’, Buttonwood Gathering, New York (25 October 2010), pp. 6–7.
12. Joseph Yam, HKMA Chief Executive, ‘Viewpoint: Alan Greenspan and the Federal Reserve’, *HKMA*, 1 February 2001.
13. Andrew Sheng, *From Asian to Global Financial Crisis: An Asian Regulator’s View of Unfettered Finance in the 1990s and 2000s* (New York: Cambridge University Press, 2009), p. 391. He was not alone in voicing such suspicions. See, for example, ‘Basel brush: Regulators’ new blueprint for bank supervision avoids the trickiest bits’, *Economist*, 2 April 2009.
14. The silence was not universal. Professor M. D. Nalapat stated that the reason for Washington and London ‘relaxing their already weak regulations’ was that ‘in the UK, the monetary authorities have close ties with financial institutions and individuals who make most of their profits from speculation, in the US, high-level officials are almost always chosen from among people who are experts in market-distorting activities’. See his ‘Yuan target of greedy speculators’, *CD*, 21 May 2010.
15. *The Irish Banking Crisis Regulatory and Financial Stability Policy 2003–2008. A Report to the Minister for Finance by the Governor of the Central Bank* (31 May

- 2010), pp. 16–7. This assessment is supported by the analysis in Klaus Regling and Max Watson, *A Preliminary Report on The Sources of Ireland's Banking Crisis* (Dublin: Government Publications, 2010), pp. 36–42.
16. The case for viewing officials as captured by leading financial institutions in the Basel II discussions is well argued in Jasper G. W. Blom, 'Governance pattern and market structure: the case of banking supervision under the Basel Capital Accords', *GARNET Working Paper No: 66/09* (June 2009), pp. 8–9, 16–21 and 26 especially. However, the agreement to concessions sought by banking interests can also be interpreted as no more than the compromises necessary for a successful outcome to international negotiations on economic issues in a global environment dominated by a conviction that free and competitive markets are the surest way to prosperity.
 17. 'And disclosure itself is arguably inadequate at present in relation to both off- as well as on-balance sheet activity. However much it may be a matter of regret, and despite best intentions, the transparency of today's accounts has become less and the opacity greater than was the case in former days, thereby giving a less than complete or reliable view of overall risks'. Andrew Large, BofE Deputy Governor, 'Basel II and Systemic Stability', British Bankers' Association — Basel II/Cad 3 Conference (13 March 2003), p. 6.
 18. Christopher Cox, SEC Chairman, Address to the Joint Meeting of the Exchequer Club and Women in Housing and Finance (4 December 2008).
 19. King, 'Banking: From Bagehot to Basel, and Back Again', p. 9.
 20. Ben S. Bernanke, FRB Chairman, 'Economic Challenges: Past, Present, and Future', speech at the Dallas Regional Chamber (7 April 2010).
 21. Jose Viñals and Jonathan Fiechter, 'The Making of Good Supervision: Learning to Say "No"', *IMF Staff Position Note SPN/10/08* (18 May 2010), p. 5.
 22. Kodres and Narain, 'Redesigning the Contours of the Future Financial System', *IMF Staff Position Note SPN/10/10*, pp. 4, 17–8.
 23. Stijn Claessens, Giovanni Dell'Ariccia, Deniz Igan and Luc Laeven, 'Lessons and Policy Implications from the Global Financial Crisis', *IMF Working Paper WP/10/44* (February 2010), p. 17.
 24. The survey covered '165 banks with assets in excess of US\$50 billion and 386 banks with assets in excess of US\$10 billion'. Andrea Beltratti and René M. Stulz, 'Why Did Some Banks Perform Better during the Credit Crisis? A Cross-Country Study of the Impact of Governance and Regulation', *Dice Center WP 2009-12* (July 2009), pp. 2, 3, 21.
 25. Gert Wehinger, 'The Turmoil and the Financial Industry: Developments and Policy Responses', *OECD Financial Trends*, Issue 1 (2009), pp. 7, 15.
 26. Special Inspector General for the Troubled Asset Relief Program, 'Extraordinary Financial Assistance Provided to Citigroup, Inc.', Washington DC (13 January 2011), pp. 41, 42, 43.
 27. King, 'Banking: From Bagehot to Basel, and Back Again', pp. 10–4.
 28. Andrew Bailey, BofE Executive Director, 'Financial Reform', London (21 September 2010), p. 5.
 29. Andrew G. Haldane, BofE Executive Director, 'The \$100 Billion Dollar Question', comments given at the Institute of Regulation & Risk, Hong Kong (30 March 2010), pp. 3, 4.

30. Even the AIG rescue package may prove profitable. Jackie Calmes, 'TARP Bailout to Cost Less Than Once Anticipated' and Mary Williams Walsh, 'A.I.G. Reaches Deal to Repay Treasury and Fed for Bailout', *New York Times*, 30 September 2010. 'Clearly, it was not apparent when the TARP was created two years ago that the cost would turn out to be this low. At that time, the U.S. financial system was in a precarious condition ... However, the cost has come out toward the low end of the range of possible outcomes anticipated when the program was launched'. Congressional Budget Office, *Report on the Troubled Asset Relief Program — November 2010* (Washington DC: CBO Report, 2010), p. 2.
31. Haldane, 'The \$100 Billion Dollar Question', p. 19.
32. Sir Andrew Large, BoFE Deputy Governor, 'Financial Stability Oversight, Past & Present', speech at the London School of Economics (22 January 2004), p. 19.
33. Bernanke, 'Financial Reform to Address Systemic Risk'.
34. House of Commons Treasury Committee, *Banking Reform Seventeenth Report of Session 2007–08* (London: HMSO, HC 1008, September 2008), pp. 100–2.
35. An exception would be made only 'to avoid serious disturbance' to the national economy. Ian Bond, BoFE Financial Crisis Management Division Head, 'Managing a Bank-specific Crisis: A UK Perspective', BBA workshop on managing a bank-specific crisis (26 October 2006), p. 3.
36. Mervyn King, BoFE Governor, 'Banking and the Bank of England', speech to the British Bankers Association, London (10 June 2008), pp. 3–4.
37. But note the criticism of the Bank of England for invoking moral hazard in the same report: 'We are unconvinced that the Bank of England's focus on moral hazard was appropriate for the circumstances in August [2007]. In our view, the lack of confidence in the money markets was a practical problem and the Bank of England should have adopted a more proactive response'. House of Commons Treasury Committee, *The run on the Rock Fifth Report of Session 2007–08*, Vol. I. (London: HMSO, HC56-I, January 2008), pp. 43, 74, 77.
38. Cox, Address to the Joint Meeting of the Exchequer Club and Women in Housing and Finance.
39. An exception would be made only when collapse might cause 'further serious destabilization of the financial system'. Bernanke, 'Financial Reform to Address Systemic Risk'.
40. A good example was the way 'systemic risk' was defined in 2009 as including an 'imbalance' created by 'unintentionally favor[ing] large systemically important institutions over smaller, more nimble competitors, reducing the system's ability to innovate and adapt to change'. Mary L. Schapiro, SEC Chairman, Testimony concerning Regulation of Systemic Risk before the Senate Committee on Banking, Housing and Urban Affairs (23 July 2009). Innovation had been a prominent feature of the largest firms' business models before the crisis, of course.
41. Turner, 'Something old and something new: Novel and familiar drivers of the latest crisis'.

42. Lord Turner, 'What do banks do, what should they do and what public policies are needed to ensure best results for the real economy?', Speech at the CASS Business School (17 March 2010), p. 30. See also his observation that 'some of the most profitable market making activities ... are actually relatively low risk', p. 26, f.n. 26.
43. Ricardo J. Caballero, 'Sudden Financial Arrest', *IMF Economic Review*, Vol. 58, Issue 1 (August 2010), p. 24.
44. 'A material contributor to this crisis was the failure of the official regimes for overseeing the financial system — the intellectual framework, the machinery, and regulation and supervision — to keep up with the extraordinary evolution of our capital markets over the past two decades or more'. Paul Tucker, BoE Deputy Governor, Remarks at the Institute of International Bankers Annual Breakfast Regulatory Dialogue, Washington, DC (11 October 2010), p. 2.
45. See, for example, Sheila C. Bair, FDIC Chairman, Statement on the Causes and Current State of the Financial Crisis before the Financial Crisis Inquiry Commission (14 January 2010); King, 'Banking: From Bagehot to Basel, and Back Again', pp. 3–6.
46. King, 'Banking: From Bagehot to Basel, and Back Again', p. 9.
47. Daniel K. Tarullo, FRB Governor, 'Involving Markets and the Public in Financial Regulation', speech at the Council of Institutional Investors Meeting, Washington, DC (13 April 2010).
48. Michael Barr, US Treasury Assistant Secretary for Financial Institutions, Remarks on Regulatory Reform to the Exchequer Club, Washington, DC (15 July 2009).
49. Wang Huaqing, CBRC Vice Chairman, Speech at the 2010 Lujiazui Forum (26 June 2010).
50. Jiang Dingzhi, CBRC Vice Chairman, 'Reform and development of China's banking industry in the past thirty years', speech at the CCISSR Forum, Peking University (10 April 2008).
51. Cai Esheng, CBRC Vice Chairman, Speech at the China Financial Summit Meeting (19 May 2009).
52. Jiang, 'Reform and development of Chinas banking industry in the past thirty years'.
53. Wang, Speech at the 2010 Lujiazui Forum.
54. Yam, 'The Political Process of Monetary Management'; 'Viewpoint: Alan Greenspan and the Federal Reserve'; and 'Viewpoint: The roles of the HKMA', *HKMA*, 8 June 2000.

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