"Policy preferences in financial governance: public-private dynamics and the prevalence of market-based arrangements in the banking industry"

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Policy preferences in financial governance: public-private dynamics and the prevalence of market-based arrangements in the banking industry

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Abstract

This article investigates the process of policy preference formation in global financial governance by examining the changing nature of supervision in the banking industry. The article argues that transparency and market-based supervision are now an integral and formal part of the supervision process, thus providing a public role to the private sector. The analysis focuses specifically at three levels of practice: official supervision in the context of the Basel process; private initiatives and voluntary frameworks of best practice standards; and informal market channels. The article shows that the private sector has used the above means to acquire supervision functions, thus altering the nature of supervision. The analysis highlights the costs and risks of active private sector involvement and calls for stronger accountability patterns and improved disclosure. In addition, it contrasts market-based supervisory arrangements with economic ideas about market discipline and shows that the mix of political and economic imperatives leads to a set-up where private financial institutions have the power of initiative but few incentives to fear market discipline. The article explains how and why private interests are internalised in financial policy processes and focuses on the existence of a transnational policy community of public and private participating actors who are in fundamental agreement about policy. The changing nature of supervision results from developments in global financial integration but also, the different ways in which global financial governance is generated.

Keywords: banking, Basel standards, market discipline, legitimacy, supervision

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Introduction

Transparency and market-based supervision: defining the policy issues

Recent developments in liberalisation and innovation have altered the operation of financial markets and consequently, fundamentally changed global financial governance, notably by posing significant constraints on the traditionally public functions of regulation and supervision. State actors are no longer capable of adequately guiding and overseeing financial activities that transcend national regulatory and legal boundaries. At the same time, they appear unwilling to reverse this pattern, for fear of harming their competitiveness.[1] Transnationalisation has not, however, relieved pubic authorities of their regulatory and supervisory responsibilities. Instead, the challenge is to promote market efficiency and stability while sharing authority with a growing number of actors, including the private sector. The focus has shifted from regulation to supervision and much of the emphasis placed on systemic stability, i.e. the prevention of crises. This has left financial institutions in charge of making their own rules, or rather creating their own flexible standards, and public authorities in charge of market-based supervision, increasingly reliant on private sector know-how and transparent practices.

Industry actors, and in particular large and global financial conglomerates, are participating in the formulation and implementation of both regulation and supervision. The two are interlinked but distinct functions; regulation relates to the 'establishment of specific rules of behaviour' and supervision to the 'more general oversight of financial firms' behaviour' (Goodhart et al, 1998: xvii). Self-regulatory practices have, to varied degrees, long been established in the financial markets. This is especially true of the securities industry but there have also been various cases of authority sharing among public and private actors in the banking industry. Self-regulatory traditions exist in many systems where 'regulation is, characteristically, a public function done by private interests' (Moran, 1991: 14). The trend has accelerated in recent years as best practice standards formulated and promoted by private groups have been widely accepted by public officials. Market-based or self-supervision, on the other hand, is a more novel step. Market discipline has long accompanied official efforts; however, transparency has been put at the centre of the supervisory process, which also increasingly relies on the consistent use of internal models and risk-management techniques.

This article is organised in four parts. The first section explores the role of the private sector in the supervisory process by focusing on three levels: official procedures in the context of the Basel Committee on Banking Supervision (Basel Committee) proposals; the private promotion of best practice standards; and informal mechanisms of market discipline. The second section assesses the policy role of the private sector and examines its implications for efficiency and stability. The third section evaluates the consequences of market-based supervision for our understanding of preference formulation and global financial governance and analyses how the private sector has entered the policy community. Finally, the article examines ensuing questions of legitimacy and accountability in current financial governance arrangements. The argument of this article is that private sector preferences have been internalised in financial policy processes; this has not necessarily happened as a result of a conscious strategy of capture but rather, as the consequence of the practice of public-private interaction and agreement among a coherent transnational policy community.

Supervisory practices: 'markets are an ally in the system of supervision'[2]

Official recommendations and disclosure practices

Public authorities are interested in having access to relevant information but due to expertise and sheer volume constraints on their authority, they are also keen to promote more transparency within the market. Speaking on behalf of the Federal Reserve Board, former Governor Laurence Meyer summarised the position of official regulators and supervisors as follows:

> we have limited public policy choices for large and complex organisations. Choice 1: we can accept systemic risk as a cost of having large, global organisations in the marketplace. Choice 2: in order to limit systemic risk, we can adopt very detailed regulation and supervision programmes that include a growing list of prohibitions. Choice 3: we can rely more on market discipline to supplement capital reforms and can maintain a level of supervision similar to the one we have today. Given the choices, we simply must try market discipline (Meyer, 2000: 2-3).

Similarly, William McDonough (2002), former President of the Federal Reserve Bank of New York, has argued that the principal elements of supervision in the twenty-first century are 'effective bank-level management; market discipline; and, official supervision'.

In the language of public officials, market discipline has come to be associated with transparency and increased disclosure. The Basel process, the principal arena for standard-setting in global banking regulation and supervision, has been instrumental in promoting market-based supervision by producing frequent reports on disclosure. In a consistent effort to strengthen and improve transparency as a supervisory mechanism, recent studies have concentrated on the right balance between quantitative and qualitative disclosures, consistency in risk assessment and disclosure methods, and the regular release of information. These recommendations do not stand alone but are complemented by comprehensive regular surveys of industry practices.[3] Most importantly, however, the key role of market-based supervision can be seen in the New Capital Accord currently being finalised, the ultimate banking rules on capital adequacy. The revised Accord, Basel II, is being developed through a lengthy consultation process with strong private sector involvement. It is built as a three-pillar framework, each pillar dealing with minimum capital requirements, supervisory review procedures and market discipline respectively (Basel Committee, 2001a). Pillar 1 is indicative of the trend of public-private interaction and has been negotiated with financial institutions; it includes provisions for the use of internal risk-assessment methods for the most sophisticated private players. Pillar 2 focuses on the supervisory review process, proposing practices that will allow supervisors to evaluate banks' risk-management techniques and internal procedures. Pillar 3 is at the centre of the drive towards transparency and the endorsement of market mechanisms for supervisory purposes; it puts forward disclosure requirements and recommendations which aim to strengthen market discipline by allowing market participants (and hence, counterparties) to access information on risk-management and measurement. The Basel Committee recommends quantitative and qualitative disclosures in the areas of capital, risk exposure and capital adequacy, and on a regular basis (often more than once a year). The Committee also expects that an enforcement mechanism will be in place, ranging from 'moral suasion' to reprimands and fines (Basel Committee, 2001b).

Enhanced transparency should allow market participants to access relevant information on a bank's capital adequacy and hence, its ability to absorb losses. Moreover, disclosure may explain a firm's risk management and appetite for risk. Finally, comparability between different institutions but also among an institution over time might be improved. A close analysis suggests that the instruments and models disclosed contain little specific information. What they do, however, is provide ways to distinguish the better-managed firms, or at least those who have the most sophisticated risk-management techniques at their disposal, and to determine institutions' positions with respect to financial innovation.

But what does market-based supervision in the form of disclosure translate to in practice? Despite banking industry concerns about cumbersome requirements,[4] disclosure often involves a few extra paragraphs and additional figures in institutions' annual reports and supervisory statements. There is generally a short description on the firm's risk-management, pledging management understanding and compliance with internal standards. Furthermore, the reports include quantitative and qualitative information about different types of risk, including market, credit and operational risk.[5] In many respects, it is the innovations in risk-management and hence, the use of internal models for the calculation of risk and for regulatory purposes that lead to market-based supervision of these techniques. Calculations of risk use models such as value-at-risk (VaR), which provide one number that represents the probability of a banking institution falling below a certain pre-agreed level of losses. VaR models rely on historical data and base their credibility on back testing, i.e. the number of exceptions during a certain period of time. VaR models refer to average losses and do not include a worst-case estimate. For this reason, most institutions complement their models with stress testing, statistical models that test risk management when liquidity is low and capabilities are stretched.

Models, of course, come with assumptions and limitations. Collecting data within global institutions and across time zones is challenging, compromises take place to achieve speed and it is a myth that institutions can get a figure at the push of a button. VaR models are in a way perfectly suited to current patterns of disclosure, as they provide no proprietary information. They tell us nothing about which markets the firm is active in, what its strategy is, or in which direction it is positioned. Nor do they really tell us anything about the firm's risk appetite. Models can also be less than reliable as they are only as good as the people who operate them. Public officials are generally satisfied that most large institutions employ very able people but that is no guarantee that human error won't occur. Moreover, there is a growing gap in expertise between those devising the models (the 'rocket scientists') and those who actually apply them to the institution's activities. It is also useful to remember that financial markets are renowned for operating on the basis of 'herd behaviour' and decision-makers within an institution may choose to ignore models for the sake of profitability.

Private sector initiatives: self-regulation and market-based supervision

Just as in the case of the Basel process, self-regulatory activity and the promotion of best practice standards by private actors lead to market-based supervision of the respective financial activities. The plethora of such private initiatives in recent years highlights the extent to which market actors have acquired regulatory and, arguably, supervisory functions. There have been instrument-related private sector efforts, such as those targeting derivatives products by the Group of Thirty and the Derivatives Policy Group.[6] Specific risk types have also been addressed, as in the context of the Counterparty Risk Management Policy Group, which focused on credit risk management practices. Another private sector group, the Shipley Group, issued a report on disclosure practices by banks and securities firms. Finally, a wide variety of established business associations have taken over a standard-setting regulatory role at various stages of the policy process. The Institute of International Finance, for example, a global banking association that concentrates its efforts on international agreements such as Basel II, has played an active consultative and lobbying role in the drafting, revising and finalising of the Accord, as well as providing additional guidance on disclosure. What these initiatives have in common is the frequent head start of the private sector in a variety of vital financial policy issues. While they have been more or less influential in final policy outcomes, they have taken centre stage in the debates and given legitimacy to private sector involvement in the making of regulation. These self-regulatory initiatives also included specific proposals for voluntary frameworks for enhanced and increased disclosure as the basis for supervision of the financial activities in question. Though improvements in transparency are to be welcomed, the limitations outlined with respect to Pillar 3 also apply to private sector initiatives.

Market discipline, market actors and informal channels

Transparency and market-based supervision are further facilitated by more informal mechanisms. Firstly, there are a limited number of institutions large enough to have the potential to cause systemic risk (systemic risk refers to cross-infection from a problem in one part of the system). Financial activity is concentrated among a small cluster of financial institutions that have developed sizeable exposures to each other. This trend is rationalised by the willingness of all banks to have highly rated counterparties. As a result, there are under twenty banks, mainly New York-based, which are responsible for the bulk of financial operations. A bank's geographical location is relevant, as Wall Street is a small and tight community with several informal channels of communication. There are flows of information and gossip, which allow institutions to know a fair amount about each other's activities. Such anecdotal evidence can be especially useful with respect to the larger institutions. Banks also gain market knowledge by competing for the same clients; in turn, this can make them copy respective positions. Finally, there is the issue of frequent movement of employees (especially loan officers and traders) who take with them expertise but also, some proprietary information.[7]

Market discipline itself can also be a strong supervisory tool. The near-failure of Bankers Trust, an investment bank, at the height of the over-the-counter derivatives scandals of the mid-1990s was a poignant reminder of how a respected institution can find itself in an uncomfortable situation and probably saved the industry a lot of money.[8] This led to more responsible risk management but also gave banks the incentive to monitor other banks (especially their major counterparties).

Other market actors can ensure sound practices, notably rating agencies, which generally do the important job of cross-examining managers over the numbers produced by the models they use.[9] The market also signals the robust health or doubtful standing of an institution in the form of equity analyst reports or the interest rate that a bank has to pay on its debt.

These measures are not conclusive but they do constitute useful transparency mechanisms. In fact, in the case of some of the larger financial institutions, the market tends to identify problems first whereas supervisors might choose to ignore signals because of political considerations.[10] Finally, past crises have demonstrated that available information is by no means a sufficient condition for stability; both market participants and public officials need to be prepared to look for and at the information and also, take the time to interpret it sensibly.

A policy role for the private sector

Private authority is not a novel phenomenon in financial governance. There has long existed a pattern of dialogue and interaction between the public and private sectors, and a tradition of self-regulation in the securities and banking industries. Nevertheless, the crash of 1929 and the consequent depression brought about strong public agencies and, despite private sector involvement, for most of the twentieth century, there was some clarity with regards to public and private functions, with regulation and supervision firmly in the hands of public authorities. The above analysis shows that the balance has shifted and that the private sector has not only acquired a formal regulatory role but also, a supervisory one.

But what does the term ‘private sector’ actually refer to? With respect to Basel II, but also in relation to the growing emphasis on transparency and market-based supervision, the process is essentially led by US banking industry concerns, those of large financial institutions in particular. Their preferences for market-generated standards and market-based oversight solutions have been internalised in the Basel process, and as a result, large sophisticated banks are the best placed and best suited to the ensuing proposals. This is especially important in light of recent developments with regards to the adoption of Basel II; US regulators have decided to apply the new rules only to the top ten banks on the basis that they are too costly for smaller players. Banks in other regulatory spheres, notably in the European Union, will not enjoy the same dispensation.

It is also important to differentiate between ‘private sector’ and ‘market’ and consequently, between private sector preferences and market discipline. Is market discipline pursued seriously by either the public or the private sectors? In fact, some opponents of Basel II argue that the latter is not going far enough in the direction of market discipline and advocate a subordinated debt requirement, whereby banks would need to secure their assets with a proportion of uninsured long-term subordinated debt; the yields on this debt would indicate both risk appetite and market circumstances (Shadow Financial Regulatory Committee, 2001). In economic terms, market discipline amounts to much more than transparency and disclosure: ‘transparency of risk and capital positions; incentives to process information; formulation of unbiased estimates of the probability of default reflected in appropriate price and quantity sanctions; and bank responses to increase in price and/or reduction in quantity by reducing exposure or increasing capital’.[11] This means that not only must there be adequate information available to market participants but also, that these participants must be at risk of loss and that a negative market view of a financial institution must have significant effects. It becomes apparent that policy proposals do not deal with most of these issues and that indeed, most of what is interesting and potentially effective about market discipline would be taking place outside the Basel process. There are, indeed, significant limits to market discipline, such as the existence of safety nets and deposit insurance, and the central bank function of lender of last resort, especially for institutions that are ‘too-big-to-fail’.

These are strong political functions and considerations, which also provide a great degree of security to the private sector.

As a result, concerns remain as to how responsibly the private sector takes its policy role, as well as with regards to the safeguards that are in place should something go wrong. The probability of failure for a financial institution cannot and should not be driven to zero, but in the current financial environment, the private sector enjoys a great degree of autonomy without assuming a corresponding level of responsibility; the public sector is (or will be) thus left with the task of picking up the pieces when private sector decisions prove detrimental to the stability of the financial system.

In the first place, this financial structure can lead to moral hazard; global banks can rip the benefits of their involvement in the making of regulation and the conducting of supervision but also fall back on the state in times of problems. Public authorities have traditionally assumed functions of lender-of-last resort for illiquid institutions and provided a safety net for depositor protection. More awkward is the more unofficial role of central banks as rescuers of insolvent institutions that are considered 'too-big-to-fail'.[12] Indeed, because of the tradition of providing liquidity support, central banks can find that they are providing a 'significant subsidy to the risk management industry' (Steinherr, 1998: 276). The rescue of the US hedge fund Long-Term Capital Management in 1998, with private money but Federal Reserve logistical support indicates that there may be an increasing number of big players that matter to systemic stability. The Federal Reserve may not have used public money that time but its intervention still hints that it is prepared to act decisively to avoid a crisis. This may leave some in the private sector off the hook. Finally, it is important to look at the wider economic context. Failures can affect actors with no direct participation in the operation of global financial markets; this has been acknowledged by policy-makers:

> following a wave of financial liberalisation, the financial system has come to play a much larger role in the allocation of resources than was the case twenty-five years ago. The capacity of financial system weaknesses to generate strains and even crisis has therefore grown. So have the real economic consequences when the system malfunctions.[13]

The adoption of self-supervision practices (as well as self-regulatory ones) was arguably facilitated by the economic climate of the 1990s. After numerous financial system glitches in the 1980s, economic fundamentals in the last decade were sound and the financial system overall was considered to be healthy (especially in its ‘Anglo-American’ form). Stock markets performed remarkably and confidence in the market was high. This gave the Federal Reserve considerable room for manoeuvre to push its preference for self-regulation and market-based supervision. The underlying assumption was that economic climate allowed for small indiscretions.[14] The framework was further enabled by the status of Alan Greenspan, Chairman of the Federal Reserve Board, not just in the financial policy community, but also in the wider government and legislative circles (Sicilia and Cruikshank, 2000). There was, however, a shift in market circumstances, accompanied by a crisis of public confidence following the corporate scandals of 2002. While the full involvement of large financial institutions in these debacles has not been fully established, the lack of transparency and the problematic role of auditing firms are cause for concern. Are these the people who are asking us to trust them?

In the banking industry, the private sector is writing its own script, increasingly influencing not just the function of regulation but also that of supervision. Private actors are contributing towards and sometimes defining the emerging structure of the financial system but currently, they are taking advantage of their position without making themselves fully accountable. Along with improved disclosure, the issue of clearer patterns of responsibility, and that of a more open and visible policy role for the private sector need to be urgently addressed.

The private sector exerts significant influence over its own regulation and supervision:

> Financial crashes occur because of collective abandonment of common sense by the market. The history of finance, from the tulip mania of 1637 to the dotcom bubble, is full of such lapses. Only a captured regulator could conclude that an industry of such systemic importance, so prone to mutual self-delusion, is ready for more self-regulation (Persaud, 2002).

This paper argues that, in fact, the current financial environment encourages not only self-regulation but also, self-supervision. Private interests have been internalised by the policy community and the consequences of such private sector policy involvement are not being appropriately assessed.

Understanding global financial governance

The influence and authority of the private sector over its regulation and supervision have affected the wider context of global financial governance. Private institutions, individually or through membership of various industry associations and other private groupings, help shape policy preferences because they are now part of the policy community. Members of the community appear to have common goals and similar beliefs and present a unified front; whereas some debate may indeed be taking place about the public-private balance within the community, no one is openly questioning the general benefits of the interaction, nor indeed, of the main policy orientations that it entails. As a result, the level of controversy that is often associated with important and potentially explosive financial issues is not fully reflected in the making of policy. In this context, the influence of the private sector participation is seen as legitimate. Legitimacy stems from the situation of 'revolving doors' among financial sector employees; eventually, those in charge of regulation and supervision and those representing the financial institutions being regulated and supervised are the same group of people. Most importantly, however, the complexity and speed of financial innovation has put banks in a privileged position as knowledge holders. Public authorities lag behind in terms of technical capabilities and expertise. If regulators and supervisors can't keep up with the development of financial products that are complex, often tailor-made and used by a variety of institutions and firms, they cannot regulate nor supervise effectively. As a result, private initiatives gradually take over important functions and promote standards based on private practice. This transfer of authority is further assisted by the reputation of 'finance' as complicated and technical. Financial issues attract limited attention as evidenced by the 'low domestic visibility of the issue of financial liberalisation among politicians and the general public' (Helleiner, 1994: 14). This has helped to de-politicise global financial matters and to account for public-private dynamics in the making of policy in technical terms (Picciotto and Haines, 1999).

But why is there such underlying agreement among public and private sector officials on transparency and market-based supervision? This conformity is based on public and private sector representatives belonging to the same financial policy community; public officials and practitioners have common educational and professional backgrounds and regularly meet and network in their professional capacity. [15] In Cerny's analysis,

> both formal and informal private organisations and relationships, which themselves are organised more and more around international competition and transnational linkages, come to set standards and to shape practices (including 'best practice' and 'benchmarking') which are then transmitted in a feedback process at domestic, transnational and international levels through both private and state action operating in mutually reinforcing ways (Cerny, 2002: 202).

Moreover, 'transnational policy communities of experts and professionals that share their expertise and information and form common patterns of understanding regarding policy through regular interaction' bring about 'policy convergence' (Stone, 2001). Contact can be formal, as in the case of the Basel Committee, semi-formal, in the context of private association meetings, or informal, based on personal relations and unofficial interaction. This concentration of specialist policy-makers facilitates agreement among the members of the policy community but also acts as an exclusion zone for alternative points of view.

What does this mean for our understanding of financial governance? Public and private actors advance market structures, which promote private interests and moreover, move policy-making procedures to the transnational level, leading to policy harmonisation. In this context, going beyond sterile distinctions of 'public and private' enhances our understanding of global financial governance and reveals that public and private are working together to get markets to operate in a certain manner and that their combined decisions have an impact on the relative balance of public and private in the proceedings. In turn, this suggests that those same actors and the policy community could express preference for alternative market structures and a different degree of private sector influence. The market is a policy tool (Pauly, 2002) and the transnational policy community is made up of both public and private actors; it is thus possible to conceive of the balance shifting again and of state actors reasserting authority (Weiss, 2003).

Bringing the politics back in? Legitimacy and accountability

When examining the legitimacy of global financial governance arrangements, we also need to look at the legitimacy of policy priorities, actors and the structure as a whole. The analysis of this article shows that the policies that make up global financial governance are accepted as legitimate primarily as a result of the high level of expertise involved in the policy process. But does this make policy priorities legitimate? The transnational policy community focuses on efficiency and stability over social or distributive justice, which is also a public good (Kapstein, 1999). In practice, this means a shift of economic policies and a phasing-out of the welfare role of the state in favour of support of the private sector. These conflicts are not new: Polanyi (1944) provided an account of nineteenth century finance which highlighted tensions and attempts to reconcile laissez-faire economics and an active social role for the state.

Inevitably, these policy priorities produce winners and losers. In other aspects of economic governance, policy outcomes in terms of winners and losers are easily apparent; Sell's (2003) analysis on the influence of private actors over the regime of intellectual property protection shows a clear impact on the ability of states in the developing world to tackle health issues and the HIV/AIDS crisis in particular. The identification of 'losers' in the politics of banking supervision is more subtle; the failure of regulation and supervision can impact workers who become unemployed as a result of a currency crisis or taxpayers who have to bail out insolvent financial institutions (Porter, 2001). More generally, Cutler et al. (1999: 369) argue that private actor authority leads to decisions about 'who gets to play, what are the limits on play, and often who wins'.

The legitimacy of actors in the current arrangements is equally problematic. Authority is linked to legitimacy (Friedman, 1990). Hurd (1999) argues that the 'operative process in legitimation is the internalisation by the actor of an external standard', a standard other than self-interest. In global financial governance, external standards tend to revolve around stability and efficiency and, thus, are too closely linked to private sector interests. This also has consequences for the legitimacy of public actors: 'when states delegate effective authority to actors in private markets, both the act of delegation and the future performance of those actors have implications for their own continued legitimacy' (Pauly, 1997). The state's relations with its non-financial constituencies are thus compromised.

Finally, what is the legitimacy of the structure of global financial governance? Germain (2001) proposes the principle of inclusion as a way to enhance legitimacy. While it is the case that the institutional framework became more inclusive in the aftermath of the Asian financial crisis, the core of governance arrangements is, however, still inhabited by a relatively small number of financial institutions and public authorities with a strong North American and European bias.

The legitimacy of non-state actor influence and authority becomes more problematic when we examine accountability patterns relating to the activities of these actors. This is particularly true in global finance, where policy-making remains 'esoteric' and leads to a 'limited democracy' (Coleman, 1996: 10). Against this background, the 'power of the vote in shaping public policy decreases' (Reinicke, 1997) while at the same time, the private actors that hold authority are not part of a mechanism that assigns appropriate responsibility. 'Market actors are neither elected nor politically accountable' (Cohen, 1999). In this context, who, or what, are policy-makers (public and private) accountable to? It would be tempting to answer that the main accountability mechanism is the 'market'. Nevertheless, when losses happen, or crises occur, market mechanisms do not always take over by inflicting 'punishment' or 'discipline'. Instead, the public sector does act to remedy problems and its interference affects a wider set of actors in ways that are not explicitly recognised by the governance framework. This is further evidence that *who* exercises authority matters and that in the current financial governance arrangements, under the pretext of market efficiency, private interests have been internalised by the transnational policy community.

Conclusions

This paper has provided an overview of trends and practices in the supervision of financial markets and has shown that the policy process is influenced by private sector preferences, as evidenced in the promotion of market-based arrangements. Furthermore it has offered an explanation of this development based on an understanding of transnational policy communities of public and private actors that transcends traditional distinctions of public and private. This has significant implications for our understanding of financial governance and we need to think further about questions of capture of the policy process.

In identifying the market mechanisms favoured by this policy community, the paper also comes to the conclusion that despite talk of the de-politicisation of global finance, politics and private interest coincide to produce a supervisory set-up that is far from the ideal of market discipline. The existence of safety nets and lender of last resort functions of central banks remove the prospect of efficient market discipline yet there is little evidence of serious proposals that would limit safety nets or reduce insured deposits. Moreover, principles of corporate governance, despite the recent plethora of examples of 'bad practice' from the corporate world have yet to be included in policy discussions on the banking industry. This means that we need to distinguish between neoliberal economic principles and the politics of neoliberalism and that the issue of accountability of the private sector remains problematic.

Endnotes

[1] For a comprehensive discussion of these issues, see Strange (1996) Cerny (1993).
[2] Remark made by Jaime Caruana, Governor of the Bank of Spain and Chairman of the Basel Committee in the a speech at the Conference on Market Discipline, cosponsored by the Bank for International Settlements and the Federal Reserve Bank of Chicago, Chicago, USA, 1 November 2003.
[3] See reports by the Basel Committee (1998, 2002) and the Multidisciplinary Working Group on Enhanced Disclosure (2001).
[4] See responses to the third consultative document on the Basel Capital Accord, in particular the response of the Financial Services Roundtable; available on www.bis.org.
[5] Market risk is the risk of a change in the price of an asset that is related to developments in the markets and variations of circumstances of the overall economy. Credit risk is the risk that a counterparty is unable (or unwilling) to fulfil its obligations. Operational risk refers to failure due to faulty or outdated technical equipment or human error, including inadequate separation of front and back offices and unclear lines of accountability.
[6] For an analysis of these initiatives, see Tsingou (2003).
[7] Observations based on interviews with US public officials.
[8] Confidential interview with official at the Office of the Comptroller of the Currency, US.
[9] For an analysis of the role of rating agencies, see Sinclair (2001).
[10] Interviews with public officials and industry representatives substantiate this point.
[11] Richard Herring, 'How Can the Invisible Hand Strengthen Prudential Supervision? And How Can Prudential Supervision Strengthen the Invisible Hand?' Remarks made at the Conference on Market Discipline, cosponsored by the Bank for International Settlements and the Federal Reserve Bank of Chicago, Chicago, USA, 31 October 2003.
[12] Interviews with US public officials have shown that there exists an informal distinction between the legal possibility of the failure of a large financial institution and the economic one.
[13] Andrew Crockett, 'International standard setting in financial supervision', Lecture at the Cass Business School, City University, London 5 February 2003. Andrew Crockett is the former General Manager of the Bank for International Settlements.
[14] Confidential interview with Federal Reserve official.
[15] See also Gill (1990) and van der Pijl (1998).

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