2013

States and Financial Crises

Elisabeth Brooke Harrington, *Copenhagen Business School*

CHAPTER 14

States and Financial Crises

BROOKE HARRINGTON

> "Government is instituted for the common good; for the protection, safety, prosperity and happiness of the people; and not for the profit, honor, or private interest of any one man, family, or class of men…"[23]

These words, written in 1780, belong to the world's oldest constitution in continuous use: that of the Commonwealth of Massachusetts. Penned by John Adams—later the second American President (1797–1801)—they inspired the language and political philosophy of the United States Constitution, along with those of many other modern democratic states (Connor & Hammons, 2008). From this widely shared view on the purpose of government, it would seem quite straightforward to define the relationship between states and financial crises: the former should prevent the latter.

Indeed, most states act to protect the "safety, prosperity, and happiness of the people" against the depredations of financial crises in some or all of the following ways: regulation; provision of a safety net to protect individuals and key institutions from being irreparably damaged by crises; and, finally, punishment of those responsible in order to prevent crises in future. All three measures are intended to sustain public trust in financial systems. This is essential because, as former Federal Reserve Bank Chairman Alan Greenspan put it, "Trust is at the root of any economic system based on mutually beneficial exchange … If a significant number of businesspeople violated the trust upon which our interactions are based, our court system and our economy would be swamped into immobility" (Greenspan, 1999). These claims were borne out by the global financial crisis of 2008, during which trust was so depleted that banks stopped lending to one another and consumer credit became nearly unattainable (Mollenkamp *et al.*, 2008).

Since then, evidence has come to light suggesting that governments not only failed to prevent or adequately respond to the financial crisis but

23 Constitution of the Commonwealth of Massachusetts, Part I, Article VII. Available at www.malegislature.gov/Laws/Constitution (accessed October 2012).

were also complicit in its creation (Burns, 2009; Vinocur, 2009; Alderman, 2010; Stiglitz, 2010). This chapter will review the circumstances surrounding that crisis and show that such complicity is consistent with the past 300 years of economic history: since the first known financial crisis occurred in 1720, states have betrayed their core obligation to protect the interests of their citizens. This conflict will be the focus of the chapter. Other considerations—such as the state's general role in creating the economy's legal and financial infrastructure, and the role of ideas in shaping financial crises—cannot be addressed adequately within the scope of this brief essay; however, the work of Germain (2010) and Harvey (2005), respectively, offer excellent insights on these important issues.

The remainder of the chapter will unfold in three parts. First, it will review the three pillars of the state's role as protector of public finance and the ways in which each pillar collapsed during the crisis of 2008. Since much of the information on the recent crisis is available in newspapers rather than scholarly publications, this section will draw heavily on contemporary journalism to provide details for the case study. The second section of the chapter will review historical cases of government complicity in financial crises. Finally, the discussion will conclude with general observations on the conflicted position of the state vis-à-vis financial markets.

14.1 The state as protector of public finances

As Polanyi (1944) has shown, the development of capitalist market economies depends upon a strong state. States and markets develop together, with the state providing the infrastructure (such as a banking system and the rule of law) that allows financial markets to develop (Haldane, 2011). Since finance implies risk and uncertainty (Keown, 1999), growth in these markets requires a commensurate increase in the role of the state to insure individuals and social institutions against the downsides of risk. This protective structure has three pillars:

- *Regulation:* Many rules governing banking and financial activity are designed, at least nominally, to prevent financial crises from occurring in the first place. For example, the Basel Accords were instituted among the G-10 countries (Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, the UK and the US) in the wake of several major bank failures in the 1970s. The Accords aimed to prevent such crises in future by ensuring that the member states adhered to a shared set of rules on matters such as the amount of capital reserves and risky assets their banks carried (Acharya & Richardson, 2009).

- *Provision of a safety net:* When fiscal crises *do* occur, states provide safety-net programmes to contain and mitigate the damage. These include measures targeted at individuals, such as deposit insurance, which pays back depositors for any savings lost when their banks fail, or unemployment insurance, which protects income when companies lay off workers or go out of business. The safety net also covers institutions, through means such as government loans to cash-strapped banks deemed essential to the functioning of the economy. This technique was used following the Japanese economic crisis of the 1990s and was central to the US government's Troubled Asset Relief Program (TARP) following the subprime mortgage crisis of 2008 (Kregel, 2009).
- *Punishment and deterrence:* In the aftermath of fiscal crises, the state can restore public confidence in the financial system by punishing any illegal activity (such as insider trading) that contributed to the crisis. This is intended not only to administer justice to those who have broken the law but also to deter anyone who might be tempted to do so in future. For example, following the failure of many American savings and loan banks in the 1980s, "special government task forces referred 1100 cases to prosecutors, resulting in more than 800 bank officials going to jail" (Morgenson & Story, 2011). Several wealthy and prominent citizens were among those who received prison sentences, underscoring the state's goal of rebuilding trust in the system by showing that justice was administered impartially.

These government interventions serve to reduce the risk and uncertainty involved in market transactions; in this sense, the role of government is analogous to that of a referee in a sports match, setting limits so that fair play can take place. Financial crises occur when this order is disrupted. The characteristics of a financial crisis include, but are not limited to: steep declines in the prices of assets (such as stocks or real estate); failures of banks and other major economic institutions; and the breakdown of lending among institutions and individuals (Kindleberger, 1978; Minsky, 1972). In other words, financial crises occur when risk and uncertainty become so great that lending and investment contract sharply, reducing economic activity overall (Mishkin, 1992).

14.2 The 2008 financial crisis: failures of the state

The events of 2008 provide a vivid illustration of these definitions of financial crisis, and of the consequences when governments do not fulfil their obligations to prevent crises through regulation, safety net provision and punishment of wrongdoers.[24] The regulatory failures leading up to the crisis have been well documented. In the US, for example, loosened restrictions on consumer credit and the decision to allow investment banks to self-regulate have been cited among the catalysts of the crisis (Blundell-Wignall *et al*., 2008; Labaton, 2008). In the UK, a post-crisis report by the House of Commons conceded the breakdown of the country's financial oversight body, the Financial Services Authority (FSA). The report concluded that, "By any measure the FSA has failed dreadfully in its supervision of the banking sector" (House of Commons Treasury Committee, 2009:3). These observations add weight to theories positing that capitalist states, like capitalism itself, are in a continual state of crisis (Jessop, 2003)—or, what Arrighi (2010:354) termed "systemic chaos".

The scope of the 2008 crisis also showed up the holes in the financial safety net. As the International Monetary Fund recently observed (Moghadam, 2011), global crises require a global response, yet the IMF still lacks the capitalisation and asset diversity to provide a buffer against future shocks (see also Fernández-Arias & Levy-Yeyati, 2010). At the national level, an inadequate safety net in some of the largest economies threatens the rest of the system. For instance, the lack of universal health care coverage in the US dramatically increases risk and uncertainty in the country's economic system; and because the US economy is so large, its crises can spread quickly to destabilise free enterprise worldwide (Rajan, 2010).

Among the most surprising aspects of the 2008 crisis has been the absence of investigation and prosecution of wrongdoing. In the US, the Federal Bureau of Investigation actually reduced its personnel assigned to mortgage fraud cases, while the Department of Justice declined or dropped many prosecutions of financial industry executives, despite widespread evidence of illegal activity (Swedberg, 2010). This has led some observers to argue that the state's "policies have created an exceptional criminogenic environment" (Morgenson & Story, 2011), passively facilitating economic collapse.

24 All of the financial crises reviewed in this chapter involve illegal activity. The question of whether it is possible for financial crises to occur in the absence of illegal activity, while interesting, is beyond the scope of this essay.

Others argue that we should regard states as active collaborators in the destruction of their own financial systems (Lewis, 2010). This may seem puzzling: why would a state seek self-destruction? Recent accounts suggest that the problem lies in conflicts of interest on the part of those in charge of the crisis-prevention and mitigation systems: they are often the same elites who profited the most from the weakening of protective financial regulations, and benefited the most from bailouts. This process of privatising gains and socialising losses (Coates, 2010) allows government and business elites—who are often the same people (Useem, 1986)—to capture the rewards of financial risk-taking without being subject to the market discipline of losses.

Iceland, for example, went from one of the world's richest nations to bankruptcy within six months due to what the *Financial Times* (2008) called the country's "incestuous economy". With a population of just over 300,000 people, it is not surprising that Iceland's political and business leadership were virtually identical, composed of elites who not only worked together but were also educated together since early childhood, subsequently lived and vacationed in the same places and shared family ties. As a result, the representatives of the state were unwilling to set limits on, let alone punish, their friends in the financial industry, even when the risks threatened the nation's survival (Gill, 2008).

Similar observations have been made concerning the origins of the financial crisis in the US and the UK. In the former case, much of the blame at the state level has been laid at the feet of Treasury Secretary Timothy Geithner for allowing banks to take the reckless risks that led to the crisis. Geithner, who "forged unusually close relationships with executives of Wall Street's giant financial institutions" (Becker & Morgenson 2009), later proposed that the banks be bailed out at taxpayer expense when the risks went bad. This bailout, ostensibly part of the safety net provided by the US government to mitigate the damage caused by the crisis, ended up being a windfall for Geithner's business allies: "much of the Troubled Asset Relief Program in effect used taxpayer money to finance bonuses for top bank employees and dividends for shareholders with no positive impact on financial market performance" (Crotty, 2009:578). In the UK, the collapse of the Royal Bank of Scotland and the subsequent investigation by the country's Financial Services Authority was described as "the high water mark of ... the emergence of crony capitalism in the UK over the past decade" (Norman, 2011).

These interventions by government cross the line from passively creating conditions that enable financial crises to actively aiding and abetting the economic destruction of the countries they are obliged to protect. Unfortunately, these episodes are not restricted to the crisis of 2008. As the next section will show, a review of economic history indicates that state involvement in financial crises is the norm rather than the exception. Indeed, the evidence suggests that such crises may require some form of collusion by government in order to occur.

14.3 Back to the future: history's first financial crises

The historical roots of government complicity in financial crises go all the way back to 1720, with the South Sea Bubble in England and the Banque Royale scandal in France. Both crises were generated by complex schemes to offload onto the public war debts that the government was unable to pay. And both resulted not only in the bankruptcy of many individuals but also in a lasting distrust in government, business and financial systems that limited the economic development of France and England for generations.

The South Sea Bubble

The crisis provoked by the failure of the South Sea Company resulted from "corruption on an audacious scale" (Reed, 1999:38), involving Parliament, the nobility and business leaders alike. The first component of the multifaceted scheme was the establishment of a trading company that was never intended to trade. Ostensibly, the South Sea Company was established on the basis of holding exclusive rights to trade English goods with the gold-rich Spanish colonies in the Americas; in fact, those lucrative trading rights never existed and the Company never sent out a single ship. The real purpose of the scheme was to get the holders of some £10 million in short-term government debt to exchange their notes for South Sea stock, thereby privatising the national debt, which had been run up during the War of Spanish Succession.

The willingness of the public to invest in the South Sea Company depended on the imprimatur of the state. The value of the Company's shares appeared to be guaranteed because the firm had been created by an Act of Parliament, and the King himself made a public display of investing £100,000 of his own money in the venture. What the investing public did not know was that the leadership of the South Sea Company included swindlers such as Sir John Blunt, whose previous experience included running lotteries, and that members of parliament had been bribed to overlook the fact that the South Sea Company didn't have any assets (Balen 2003).Thus, when the Company stock suddenly ceased to sell, the market crashed, bankrupting many whose investments had been used to refill the royal coffers. The state's response to this destruction involved still more fraud: parliamentary leaders suppressed evidence and summarily cancelled or "adjusted" the losses of some favoured investors "so that imaginary wealth could be sucked out of the system" (Carswell, 2002). The catastrophe was so destructive to public confidence in the state and financial endeavours that joint-stock companies—one of the bases of contemporary capitalist development—were outlawed for over a century afterwards.

The Mississippi Company and the Banque Royale

Concurrently in France, the state was devising a similar plan to privatise the nation's ruinous war debts, reaching into the pockets of its citizens in order to replenish its own coffers. Like the South Sea Bubble, the disaster—known as the Banque Royale scandal or the Mississippi Company Bubble—was complex. It involved several ventures rolled into one, including the issuing of stocks in a New World trading venture (based on the French territories along the Mississippi River, hence the firm's name). In addition, the crisis hinged on the creation of a central national bank, known as the Banque Royale because it was chartered by and operated under the authority of the Bourbon monarchy.

The scheme was the brainchild of John Law, a Scottish businessman and gambler who had befriended the Duc D'Orleans, Regent for King Louis XV who was only five years old when he ascended the throne. Law offered the French Crown an audacious plan to solve its fiscal crisis, which had been brought on by the costly wars prosecuted by the previous King, Louis XIV (Murphy, 1997). By 1715, French currency reserves were running perilously low, and the state had already defaulted on some of its national debt, forced lower interest payments on other loans and instituted high taxes to service its interest payments (Garber, 2000). Under Law's direction, the Mississippi Company bought the national debt of France and then raised capital to help pay off the debt by issuing stock and government-backed bonds in the Company. Law then promoted the Company—to which the French Crown had granted a 25-year monopoly on North American trade—with claims of gold, precious gems and other wealth to be found in the French North American territories. Historians are divided on whether these claims were realistic or wildly exaggerated (see, for example, Kindleberger, 1978 and MacKay, 2008 [1841]) but, combined with the backing of the government for the Company, the claims led to rampant speculation, driving up share prices by 190 per cent in less than a year. By the time prices reached their peak in 1720, many citizens had become fabulously wealthy— at least on paper—with the result that the word "millionaire" came into common parlance for the first time (Moen, 2001).

At the same time, the state passed laws requiring citizens to make all their deposits and tax payments through the Banque Royale in gold and silver, thereby replenishing the state's bullion reserves. In return, the central bank issued paper money, to be treated as legal tender in place of the metal coins that had previously been used for all transactions; at the same time, citizens were forbidden to have more than a small private stock of gold and silver. This infusion of public wealth kept the French state afloat for a time, but led to disaster when the Banque Royale issued approximately twice as much value in paper currency as it could redeem in gold and silver. When members of the French royal family began cashing in their Mississippi Company stock for gold, a panic ensued, leading to rapid devaluation of the currency and hyperinflation, peaking at 23 per cent *per month* (Moen, 2001). The resulting economic crash crippled the national economy for years to come and instilled in the French a lasting distrust of the financial system. For example, it took France until 1800 to re-establish a national bank and resume circulation of paper currency, years after most other European nations.

Since 1720, this pattern of state complicity has been repeated with alarming frequency: the very entities charged with guarding against and punishing financial wrongdoing have been implicated in its creation and perpetuation. For example, historians have documented the essential role that counterfeiting paper money played in the development of the US, a role recognised by government and banks in the early 1800s, when as much as 10 percent of the nation's currency was fake. Thus, while the institutions of law and order sought to combat counterfeiting, they also tolerated it in many quarters, recognising that all paper currency was essentially "confidence money" and that "the activities of banking, counterfeiting and speculative capitalism coexisted on a continuum" (Mihm, 2007:16). Although counterfeiting brought about the collapse of numerous individual banks, as well as immobilising segments of the financial system at several points, the occasional financial crisis was apparently regarded as part of the cost of doing business in a rapidly expanding national economy.

The state as perpetrator of financial crises: the case of tax havens

Recently, a similar tension between governments' historical roles as crisis preventers and crisis perpetrators has developed in the arena of tax havens. Tax havens—or international financial centres, as many prefer to be called—are the focal points of inter-state competition to attract lucrative business from the financial sector. Tax havens include small nations, such as the Cayman Islands in the Caribbean or the Cook Islands in the South Pacific, as well as parts of the US and Europe, notably Switzerland and Liechtenstein. Regardless of location, all seek to create the most favourable conditions for wealthy individuals and firms to move assets to their jurisdiction, creating jobs for local citizens and generating revenues for the state through incorporation fees, taxes and other transaction costs.

Competition takes place primarily at the level of regulation and taxation; the less of both, the better. This creates a race to the bottom in terms of other, onshore states' ability to constrain financial activity in the public interest, to punish wrongdoing and to provide a safety net. For a fee, tax havens provide the legal means for firms and individuals to conceal assets from regulators and avoid paying taxes in the countries whose benefits they enjoy (Shaxson, 2011). Thus, tax havens undermine the state's role as protector against financial crises in two ways: by creating conditions that permit reckless financial risk-taking and by starving states of the revenues necessary to support financial oversight and provide a safety net to citizens.

For example, in 1998—the same year that Russia defaulted on its national debt, sending the world economy into a tailspin—an estimated US $70 billion in private wealth was transferred from Russian financial institutions to banks chartered in the tiny Pacific island of Nauru (van Fossen, 2003). Victor Melnikov, deputy chairman of the Russian central bank, said that 90 per cent of the money would return to Russia through a variety of untaxed methods; the country's wealthiest individuals and corporations "effectively evade taxes this way," causing "great damage to the country," he added (Hilzenrath, 1999). For Nauru, however, the tax haven business is a boon: as a coral atoll with a population of around 10,000, it has no economic base and was teetering on the verge of insolvency itself until it got into the business of selling the protection and privacy provided by its sovereign laws. It costs about US $20,000 to establish each new offshore bank there; while the exact number of banks chartered on the island is unknown, the fees make "a significant contribution … to the national revenue," according to Mathew Batsuia, Chief Secretary of the Republic of Nauru (Hilzenrath, 1999).

Hedge funds and the costs of increasing financial instability

Light regulation and low-to-nil taxation have also made tax havens a favourite for hedge funds—secretive, high-risk investment pools involved in several of the most costly financial crises of the past decades. Hedge funds, which are usually accessible only to institutions and the world's wealthiest individuals, exist to engage in high-risk speculation; this is appealing because, in financial theory, the greater the risk investors assume, the greater returns they can earn (Edwards, 1999). While hedge funds can exist anywhere, tax havens permit them much wider latitude to take financial risks (and therefore to earn higher profits) than do onshore jurisdictions. For example, the laws of tax havens are often written expressly to allow hedge funds to maximise profits by keeping capital requirements lower and permitting the funds to carry more debt than would be allowed onshore. The confidentiality offered by tax havens is also appealing to funds, whose formulas for speculation are often closely-guarded secrets; unfortunately, this secrecy, and the rarity with which tax havens cooperate in international legal inquiries, also makes it difficult to identify and punish criminal activity connected with financial crises.

The combination of high risk and low accountability offered by tax havens has, unsurprisingly, led to disaster at times. Prior to 2008, the best-known case was that of the hedge fund management firm Long-Term Capital Management (LTCM), whose reckless risk-taking was said to have "nearly blown up the world financial system" in 1998 (Jorion, 200:277). The failure of LTCM, whose funds were maintained in the Caribbean tax haven of the Cayman Islands, was so threatening to the integrity of the global economy that the US Federal Reserve Bank took the then unprecedented step of bailing out a failed private enterprise, at a cost of US $3.6 billion in public funds. Following LTCM, however, the hedge fund industry remained largely unregulated and continued to thrive offshore, where it later innovated a new, high-risk financial instrument, the mortgage-backed security, which helped bring down the world economy in 2008.

The price of tax evasion

The loss of tax revenues through the use of offshore banks and firms has become a serious and growing problem for nation-states, particularly during the current global economic crisis. A recent study of the EU member states suggests that one of the most important commonalities among the countries presently facing default (Greece, Spain, Portugal and Italy) is the extensive use of international financial centres for tax avoidance by their wealthiest citizens and firms (Schneider, 2011). The practice is thought to cost the UK alone some £100 billion in annual revenues (Mitchell et al., 2002). In the US, former Internal Revenue Service Commissioner (1997–2002) Charles Rossotti pointed out that this systemic underpayment of tax by individuals and corporations effectively levies a surtax on honest taxpayers, equivalent to an additional 15 per cent for many Americans (Smith, 2004:2).

The free riding of the wealthy thus weakens a country's economic development by placing an extra burden on the less wealthy and reducing funds that would otherwise be available for consumption and investment. Secondly, when governments cannot make up the tax shortfall by shifting the burden down the socio-economic ladder, the social safety net suffers. Not only do governments have less to spend on regulation, enforcement and insurance against financial disasters but the amount and quality of public services decline across the board (Mitchell et al., 2002). This is significant because the worse a country's education, health care and technological infrastructure, the less robust it is economically and the more vulnerable it is to crises (Rajan, 2010).

Conflicts of interest

Taken together, this evidence suggests that tax havens are "on a collision course with civil society" (Sikka, 2005). Indeed, this has been the public line of attack by the member countries of the Organisation for Economic Co-operation and Development (OECD), who have waged a long, but thus far unsuccessful, battle to put tax havens out of business (Organisation for Economic Co-operation and Development, 2006; Levin, 2003). The efforts have failed, in large part, due to the conflicted position of the OECD states themselves, a position that has undermined their political legitimacy and made them economically dependent on the continuing existence of tax havens (Sharman, 2006).

Many well-known financial centres, such as Jersey and the Cayman Islands, originally entered the offshore banking business at the behest and for the benefit of onshore governments (Hampton & Christensen, 2002). This included providing services vital to legitimate economic development, such as facilitating the creation of the Euromarket, a form of trade between the US and Europe that would not have been possible onshore due to restrictions on exchange rates and currency reserves (Palan, 1998). Other countries developed into tax havens as a post-colonial economic development strategy: Britain and Australia urged former dependencies such as Vanuatu to become offshore financial centres in a "deliberate policy to reduce the cost of maintaining the islands" after independence (Palan *et al.*, 2010:146). Now, many of these locales are under investigation (and threat of exclusion from global banking networks) by the same onshore governments that sponsored their development and rely on their services in order to participate in the global economy (van Fossen, 2003), once again illustrating the conflicted position of the state vis-à-vis financial crises and their sources.

14.4 Conclusion

Reviewing the nearly 300 years that have elapsed since the first large-scale financial crisis in history, we can appreciate how one historian concluded that: "At its core, capitalism was little more than a confidence game," a get-rich-quick scheme punctuated by occasional disasters (Mihm, 2007:11). As this chapter has shown, the relationship of public servants and institutions to financial crises is ambivalent at best and often frankly complicit (Galbraith, 2004; Tillman & Pontell, 1995). In this light, it is somewhat surprising that both the nation-state and the financial system have proven robust and resilient enough to survive until now.

States are essential to preserving trust in financial systems. They make contemporary global capitalism itself possible, lending value to paper currency through the "full faith and credit" of the government. When states betray that confidence by failing to regulate properly, provide an adequate safety net or punish financial wrongdoing, they create conditions in which financial crises can occur. Passive or permissive government allows the lines between legal and illegal acts to become dangerously blurred. Active government complicity in financial crises raises even more troubling questions about the position of the state in contemporary capitalist societies.

For example, given the global scope of finance and financial markets, we may well ask whether the state is still relevant as a guardian of the public interest and welfare. As the events of 2008 have illustrated, the boundaries of the nation-state can no longer contain financial crises: what happens in a tiny country like Iceland now affects the world economy. But we lack institutions that can hold actors accountable, or even determine who is responsible for what. Deregulation and new financial technologies have created a global trade in complex securities whose true value and risks are poorly understood by both traders and regulators. This creates a "criminogenic" (Tillman & Indergaard, 2007:482) environment, in which fraud and crisis are almost foregone conclusions. It would appear that some form of trans-national governance is needed to address these global financial risks, but existing institutions, such as the Organisation for Economic Development and Co-operation and the International Monetary Fund, have thus far lacked both the necessary capital and political legitimacy to take on this role (Fernández-Arias & Levy-Yeyati, 2010; Moghadam, 2011; Sharman, 2006).

Of even greater concern is recent evidence that the most common responses of the state to financial crises—tougher sanctions on criminal conduct, along with more rigorous standards for monitoring and transparency—are ineffective. For example, as Povel *et al*. (2007:1221) point out, “throughout the 1990s, improved computing and communication technologies greatly reduced investors’ costs of examining firms’ prospects, yet at the end of the decade ... a wave of frauds occurred”. Thus, regulatory efforts like the Sarbanes-Oxley bill, conceived in response to the financial crises of the early 21st century, have widely been criticised as having “fixed non-existing problems” (Brown, 2006:309) while failing to address critical systemic issues (Soederberg, 2008). Finally, wide divergences in interpretation and application of the laws, even within the same jurisdiction, make it difficult to establish clear boundaries for regulators and prosecutors to enforce in protecting the public against financial crises (Pritchard & Sale, 2005).

Going forward, the evidence on the relationship of states to financial crises offers little basis for optimism. It seems clear that the nation-state has become unable to govern financial activity on a global basis; but dispensing with it and its limitations is likely to be politically unfeasible. Then again, even if the resources and political will emerged to establish effective global governance institutions for the financial system, it is unclear whether regulation and punishment can actually work. A global safety net would present problems of its own in the form of moral hazard, potentially increasing the risk of crises by insuring against them (Rogoff, 1999). Moreover, the historical record suggests that the costs of maintaining such a safety net would be astronomical: among the 59 financial crises that occurred worldwide between the late 1970s and late 1990s, the *average* cost of each government bailout represented 4 per cent of GDP in developed countries and 9 per cent of GDP in developing countries (Caprio & Honohan, 1999). It is unlikely that any institution could raise sums on this scale without significant increases in taxation—taxes that would have to be levied on the same politically powerful economic elites responsible for the crisis. Thus, since political power and economic power are inextricable from each other, the state will likely remain in a conflicted, ambiguous and sometimes even collaborative position vis-à-vis financial crises.

References

Acharya, V. & Richardson, M. (2009) Causes of the financial crisis. *Critical Review* 21, 195–210.

Alderman, L. (2010) In Europe, a mood of austerity and anxiety. *New York Times*, 23 September, B6.

Arrighi, G. (2010) *The Long Twentieth Century: Money, power and the origins of our times.* New York: Verso.Balen, M. 2003. *A Very English Deceit: The secret history of the South Sea Bubble and the first great financial scandal*. New York: Fourth Estate.

Becker, J. & Morgenson, G. (2009) Geithner, member and overseer of finance club. *New York Times*, 26 April, A1.

Blundell-Wignall, A., Atkinson, P. & Lee, S.H. (2008) The current financial crisis: Causes and policy issues. *OECD Financial Market Trends* 1–21. Available at www.oecd.org/dataoecd/47/26/41942872.pdf (accessed October 2012).

Brown, J.R. (2006) Criticizing the critics: Sarbanes-Oxley and quack corporate governance. *Marquette Law Review* 90, 309.

Burns, J. (2009) At polls, Icelanders punish conservatives. *New York Times*, 25 April: A8.

Caprio, G. & Honohan, P. (1999) Restoring banking stability: Beyond supervised capital requirements. *Journal of Economic Perspectives* 13, 43–64.

Carswell, J. 2002. *The South Sea Bubble*. Stroud, UK: Sutton Publishing.

Coates, D (2010) Separating sense from nonsense in the US debate on the financial meltdown. *Political Studies Review* 8, 15–26.

Connor, G. & Hammons, C. (2008) *The Constitutionalism of American States*. Columbia, MO: University of Missouri Press.

Crotty, J. (2009) Structural causes of the global financial crisis: A critical assessment of the "new financial architecture". *Cambridge Journal of Economics* 33, 563–580.

Edwards, F. (1999) Hedge funds and the collapse of long-term capital management. *Journal of Economic Perspectives* 13, 189–210.

Fernández-Arias, E. & Levy-Yeyati, E. (2010) *Global Financial Safety Nets: Where do we go from here?* Inter-American Development Bank Working Paper Series, No. 231. Available at http://idbdocs.iadb.org/wsdocs/getdocument.aspx?docnum=35474343 (accessed October 2012).

Financial Times (2008) Icelandic Banks, Editorial, 14 December, 14.

Galbraith, J.K. (2004) *The Economics of Innocent Fraud*. London: Penguin.

Garber, P. (2000) *Famous First Bubbles: The fundamentals of early manias*. Cambridge, MA: MIT Press.

Germain, R. (2010) *Global Politics and Financial Governance*. London: Palgrave MacMillan.

Gill, A.A. (2008) Iceland: Frozen assets. *Sunday Times*, 14 December.

Greenspan, A. (1999) *Commencement Address*. Harvard University, Cambridge, MA, 10 June. Available at http://www.federalreserve.gov/boarddocs/speeches/1999/199906102.htm (accessed November 2012).

Haldane, A. (2011) *Control Rights (and Wrongs)*. Wincott Annual Memorial Lecture, Westminster, London, 24 October. Available at www.bankofengland.co.uk/publications/Documents/speeches/2011/speech525.pdf (accessed October 2012).

Hampton, M. & Christensen, J. (2002) Offshore pariahs? Small island economies, tax havens, and the re-configuration of global finance. *World Development* 30, 1657–1673.

Harvey, D. (2005) *A Brief History of Neoliberalism*. Oxford: Oxford University Press.

Hilzenrath, D. (1999) Tiny island shelters, huge cash flows. *Washington Post*, 28 October, A1.

House of Commons Treasury Committee (2009) *Banking Crisis: Regulation and supervision*. London: The Stationery Office. Available at www.publications.parliament.uk/pa/cm200809/cmselect/cmtreasy/767/767.pdf (accessed October 2012).

Jessop, B. (2003) *The Future of the Capitalist State*. Cambridge, UK: Polity.

Jorion, P. (2000) Risk management lessons from long term capital management. *European Financial Management* 6, 277–300.

Keown, A. (1999) *Foundations of Finance*. Upper Saddle River, NJ: Prentice Hall.

Kindleberger, C. (1978) *Manias, Panics and Crashes.* MacMillan: London.

Kregel, J. (2009) Why don't the bailouts work? Design of a new financial system versus a return to normalcy. *Cambridge Journal of Economics* 33, 653–663.

Labaton, S. (2008) SEC concedes oversight flaws fueled collapse. *New York Times* 27 September, A1.

Levin, C. (2003) *US Tax Shelter Industry: The role of accountants, lawyers, and financial professionals*. Statement by Senator Carl Levin before US Senate Permanent Subcommittee on Investigations, 18 November. Available at http://levin.senate.gov/newsroom/release.cfm?id=216379 (accessed October 2012).

Lewis, M. (2010) *The Big Short: Inside the doomsday machine*. New York: Norton.

MacKay, C. (2008 [1841]) The Mississippi Scheme. *Extraordinary Popular Delusions, the Money Mania: The Mississippi Scheme, The South Sea Bubble and the Tulipomania*, pp.1–45. New York: Cosimo.

Mihm, S. (2007). *A Nation of Counterfeiters: Capitalists, con men, and the making of the United States*. Cambridge, MA: Harvard University Press.

Minsky, H. (1972) Financial stability revisited: The economics of disaster. In: Board of Governors of the Federal Reserve System (ed.) *Reappraisal of the Federal Reserve Discount Mechanism*, Vol. 3, pp.95–136. Washington, D.C.: Board of Governors of the Federal Reserve System.

Mishkin, F. (1992) Anatomy of a financial crisis. *Journal of Evolutionary Economics* 2, 115–130.

Mitchell, A., Sikka, P., Christensen, J., Morris, P. & Filling, S. (2002) *No Accounting for Tax Havens*. Basildon, UK: Association for Accountancy & Business Affairs.

Moen, J. (2001) John Law and the Mississippi Bubble: 1718–1720. *Mississippi History*. Jackson, MS: Mississippi Historical Society.

Moghadam, R. (2011) *Strengthening the International Monetary System: Taking stock and looking ahead.* International Monetary Fund Working Paper, 23 March. Available at www.imf.org/external/np/pp/eng/2011/032311.pdf (accessed October 2012).

Mollenkamp, C., Whitehouse, M. & Shah, N. (2008) Lending among banks freezes. *Wall Street Journal*, 17 September. Available at http://online.wsj.com/article/SB122156888040242963.html (accessed October 2012).

Morgenson, G. & Story, L. (2011) In financial crisis, no prosecution of top figures. *New York Times*, 14 April: A1.

Murphy, A. (1997) *John Law: Economic theorist and policy-maker*. Gloucestershire, UK: Clarendon Press.

Norman, J. (2011) The FSA's report on RBS doesn't do enough to counter crony capitalism. *Guardian*, 13 December, 30.

Organisation for Economic Co-operation and Development (2006) *Third Meeting of the OECD Forum on Tax Administration: Final Seoul Declaration*. Seoul, Korea: OECD. Available at www.oecd.org/dataoecd/38/29/37415572.pdf (accessed October 2012).

Palan, R. (1998) Trying to have your cake and eating it: How and why the state system has created offshore. *International Studies Quarterly* 42, 625–644.

Palan, R., Murphy, R. & Chavagneux, C. (2010) *Tax Havens: How globalization really works.* Ithaca, NY: Cornell University Press.

Polanyi, K. (1944) *The Great Transformation: The political and economic origins of our time.* Boston: Beacon Press.

Povel, P., Singh, R. & Winton, A. (2007) Booms, busts and fraud. *Review of Financial Studies* 20, 1219–1254.

Pritchard, A.C. & Sale, H. (2005) What counts as fraud? An empirical study of motions to dismiss under the Private Securities Litigation Reform Act. *Journal of Empirical Legal Studies* 2, 125–149.

Rajan, R. (2010) *Fault Lines: How hidden fractures still threaten the world economy*. Princeton, NJ: Princeton University Press.

Reed, C. (1999) The Damn'd South Sea, *Harvard Magazine*, May-June: 36-41.

Rogoff, K. (1999) International institutions for reducing global financial instability. *Journal of Economic Perspectives* 13, 21–42.

Schneider, F. (2011) *The Shadow Economy and Shadow Economy Labor Force: What do we (not) know?* Discussion Paper 5769. Bonn, Germany: Institute for the Study of Labor. Available at: http://ftp.iza.org/dp5769.pdf (accessed October 2012).

Sharman, J. (2006) *Havens in a Storm: The struggle for global tax regulation*. Ithaca: Cornell University Press.

Shaxson, N. (2011) *Treasure Islands: Uncovering the damage of offshore banking and tax havens*. Hampshire, UK: Palgrave Macmillan.

Sikka, P. (2005) Accountants: A threat to democracy. The tax avoidance industry has a veto on what services the government can provide. *The Guardian*, 5 September. Available at www.guardian.co.uk/politics/2005/sep/05/publicservices.economy (accessed October 2012).

Smith, H. (2004) *Tax Me If You Can*. Transcript of Frontline documentary film. Available at www.pbs.org/wgbh/pages/frontline/shows/tax/etc/script.html (accessed October 2012).

Soederberg, S. (2008) A critique of the diagnosis and cure for "enronitis": The Sarbanes-Oxley Act and neoliberal governance of corporate America." *Critical Sociology* 34, 657–680.

Stiglitz, J. (2010) *Freefall: America, free markets, and the sinking of the world economy*. New York: W.W. Norton.

Swedberg, R. (2010) The structure of confidence and the collapse of Lehman Brothers. *Research in the Sociology of Organizations* 30A, 71–114.

Tillman, R. & Indergaard, M. (2007) Corporate corruption in the new economy." In: H. Pontell and G. Geis (eds.) *International Handbook of White Collar and Corporate Crime*, pp.474–489. New York: Springer.

Tillman, R. & Pontell, H. (1995) Organizations and fraud in the savings and loan industry. *Social Forces* 73, 1439–1464.

Useem, M. (1986) *The Inner Circle: Large corporations and the rise of business political activity in the US and UK*. Oxford: Oxford University Press.

van Fossen, A. (2003) Money laundering, global financial instability, and tax havens in the Pacific Islands. *The Contemporary Pacific* 15, 237–275.

Vinocur, J. (2009) What will change in Germany? *New York Times*, 28 September. Available at www.nytimes.com/2009/09/29/world/europe/29iht-politicus.html?pagewanted=all (accessed October 2012).