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Editorial

Financial sector reform and policy design in an age of instability

Abstract

The Global Financial Crisis (GFC) of 2008 has revealed weaknesses in financial regulatory policies and institutions in many countries. These weaknesses extend to the regional and international domains of financial policy as well. This article calls for the need for better designed financial regulations and policies by taking a policy design perspective. It provides a multi-level approach to understanding financial reform as design that examines the various components of policy design – policy means, goals and change – at the three levels of policymaking – international regional, national. In doing so, we aim to provide a first step towards a more design-centric approach to financial sector reform.
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1. Introduction

Following the Global Financial Crisis (GFC), there has been wide academic interest in the organisational and institutional reforms in financial regulation and supervision that have taken place at the national, regional, and systemic levels. In this issue, we have narrowed our analysis to the financial regulatory and supervisory reforms in banking. More specifically, we aim to understand how such financial reforms are designed and implemented by governments, drawing from the policy design literature.

As was the case with financial regulation and reform, the recent resurgence of policy design as an area of academic inquiry coincides with the GFC. While the 'globalisation' narratives that had become dominant in the 1990s and 2000s had downplayed the role of the state as an economic actor, and emphasised instead the role of non-state actors in financial and economic policymaking, the onset of the GFC shifted the attention back to governments' need to 'design' policies that are able to address the effects of the crisis (Howlett & Lejano, 2013; Howlett, Mukherjee, & Woo, 2015). There was hence a 'return of the state', with a specific focus on policy design.

The GFC also revealed weaknesses in existing financial regulatory policies and institutions, which had hampered policymakers' ability to pre-empt the crises or address its implications. Financial policies and institutions, in other words, were not designed to address the crisis. This thematic issue will therefore take a policy design approach to financial sector reforms, and aims to understand the institutional and policy design processes that may or may not contribute to effective financial sector reform. Given the severity of this GFC and its ongoing effects in the EU and US, this issue represents a timely appraisal of the importance of this topic.

The remainder of this article is organised as follows. In Section 2, we discuss the literature on policy design followed by the theoretical framework that will inform the discussion in this thematic issue. Section 3 presents a discussion on financial reforms with special reference to the components of financial reform design. In Section 4, we conclude with a summary of the contributions of the themed issue, its limitations, and suggestions for future research.

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2. Policy design

The notion that policies can be 'designed' for a specific purpose has been in existence from the very conception of the policy sciences as a field of academic inquiry. Indeed, Harold Lasswell was the first to take an instruments approach to public policy, describing polices as comprising policy means and ends (Lasswell, 1951, 1971). This would resonate with scholars of economic policy, who focused on designing policies as means or instruments (Kirschen, 1964; Tinbergen, 1956). Both means and ends are important elements of what has come to be known as the 'design orientation' in public policy.

Policy design has essentially been described as the ''deliberate and conscious attempt to define policy goals and connect them to instruments or tools expected to realise those objectives'' (Howlett et al., 2015: 291). This focus on instruments has animated much of the existing discourse on policy design. Indeed, much of the early work on policy design had focused extensively on how policy instruments could be categorised or typologised (Bressers & Klok, 1988; Hood, 1986; Salamon, 1981; Trebilcock & Hartle, 1982; Tupper & Doern, 1981; Woodside, 1986).

The aim of such activities was fundamentally to provide a more coherent and systematic understanding of the different ways in which different tools facilitated the attainment of policy goals. For instance, Hood's seminal NATO model focused on the four resources from which policy instruments derive their effectiveness – nodality, authority, treasure, and organisational – as well as the intended effects of the instrument, i.e. whether it is designed to effect change in a policy environment or monitor this environment for potential change (Hood, 1986).

Other efforts to categorise and characterise policy instruments have similarly sought to differentiate between the resources associated with the use of an instrument and the channels through which instruments influence policy formulation (Bemelmans-Videc, Rist, & Vedung, 1998; Grabosky, 1995). However, these early studies had placed a disproportionate amount of attention on examining single instruments and causal relations between a particular instrument and its policy effect. Linearity and a focus on substantive impacts would prove deleterious to understanding real-world policy design, which often involves combinations of various instruments.

In an effort to address the inherent limitations of such 'first generation' policy instruments studies, scholars of policy design subsequently sought to expand their conceptual understanding of policy instruments in several ways. First, there was a shift from single instrument studies to understanding how different combinations or 'packages' of policy instruments are designed and implemented (Elmore, 1987; Grabosky, 1995; van Der Doelen, 1998). Of particular significance is the work of Gunningham, Grabosky, and Sinclair (1998) on 'policy mixes' that sought to address and understand the interactions and complementarities between instruments.

There was thus a growing recognition that policy design involves the design and use of policy 'toolkits', rather than individual tools or instruments. A second shift in such 'second generation' policy design studies involved the distinction between 'substantive' and 'procedural' instruments, with the former directly impacting policy *outcomes* and the latter influencing policy *processes* (Howlett, 2000, 2004, 2011). This further stimulated efforts at understanding the contextual and behavioural aspects of policy design (Linder and Peters, 1989; Schneider & Ingram, 1990a; Schneider & Ingram, 1990b; Schneider & Ingram, 1994; Schneider & Sidney, 2009).

These two theoretical additions to the policy design cannons – policy mixes and procedural instruments – played a crucial role in driving a third and, for the purposes of this paper, more important shift design orientation. Specifically, policy design research became increasingly focused on the notion of 'nestedness', and how policy instruments and designs are embedded within hierarchical and cascading relations of other instruments and designs (Howlett, 2009, 2011; Howlett & Cashore, 2009). Such 'nested' or multi-level understandings of policy design have contributed immensely to the field's ability to address complexity in policy formulation (Bobrow & Dryzek, 1987; Bobrow, 2006).

Based on a delineation of the policy process into meta, meso, and micro levels, Howlett (2009) identifies three levels of policy goals; general abstract policy aims, operationalisable policy objectives, and specific policy targets, as well as three levels of policy means: general policy implementation preferences, operationalisable policy tools, and specific policy tool calibrations. These are illustrated in Table 1. This multi-level approach to understanding policy design is particularly useful for delineating and assessing policy instruments at various levels of abstraction and application.

More importantly, Table 1 provides the broad conceptual framing device for the other contributions in this issue. Taking the design approach highlighted in the framework above – with its distinction of policy goals and policy means – allows for a deeper exploration of linkages between policy means and policy goals. How does this framing resonate with the contributions in this themed issue? Oliver Butzbach argues that macro-prudential policies are not able to

Table 1
Components of public policies involved in policy design.

	Policy level		
	High level abstraction	Programme level operationalisation	Specific on-the-ground measures
Policy component			
Policy goals	General abstract policy aims	Operationalisable policy objectives	Specific policy targets
Policy means	General policy implementation preferences	Operationalisable policy tools	Specific policy tool calibrations

Source: Adapted from Howlett (2009).

achieve policy goals of fostering banking diversity and lowering systemic risk. Indeed, the inability of policymakers to pre-empt the GFC or address its negative implications in the aftermath suggests the need for a closer understanding of the ways in which policy means are connected to policy goals. However, and as other contributions in this issue also show, there is considerable overlap and complexity involved with regard to the elements identified above. For instance, Aneta Sphendzharova shows how interactions among specific policy tools at the local level can influence the broader design of policy implementation preferences at the broader and regional level. The contribution by David Howarth and Lucia Quaglia also reveal divergences among Germany, the UK and France in their programme and ground level policy means, even as they sought to achieve a shared set of high level policy goals. Conversely, Katalin Mérő and Piroska Dóra have shown how differences in high level policy goals can result in differences at all other levels of policy means.

In all instances, it is clear that taking a multi-level policy design approach allows for a deeper and more nuanced analysis of the various processes and rationales for the design and implementation of financial policies and regulations at different levels of policy. Furthermore, there is an intuitive correlation between the macro/meso/micro levels of analysis that we have provided above and the international/regional/national levels of financial policymaking. This is evident especially with regard to international regulatory standards, such as the Basel III standards, which provide a broad guideline with regard to desired policy goals and policy means, upon which more specific programmes and measures are crafted at the regional and national levels.

However, the contributions in this issue have also shown that divergences and dissonances can occur across different levels, leading to the formation of new high level policy means and goals at the national level (in the case of Mérő and Dóra) or the subversion of higher level design components by lower level ones (*a la* Sphendzharova). These complications suggest a need to match both design processes and design capacities across various levels of policymaking, as the contribution by J.J. Woo, M. Ramesh, Michael Howlett and Kerem Coban show. This suggests a normative element to our model, with the implication being the *possibility* of designing better policies at the various levels of abstraction and across national/regional/international levels of policymaking.

This is particularly important for finance, given that financial regulatory standards and other institutions operate at, and at times even span, the national, regional and international level, with each level featuring different scales of policy design and implementation. Indeed, the GFC has shown that financial policy design is crucial not only within domestic national boundaries, but at the regional and international levels as well, since these higher level institutional standards have a bearing on the formulation of domestic regulations. There is therefore a need for a closer understanding of the types of competencies and processes required for effective policy design across these levels.

While, and as we will show below, such nested and multi-level understandings of policy design exist, there remains insufficient attention paid to the macro, meso and micro-level design processes in international finance and correspondingly, their impacts at the international, regional and domestic levels. This issue will aim to address this gap. We will proceed by discussing global financial reforms in light of this policy design framework in the following section.

3. Financial reforms

If policy design is about ''studies of policy instruments and implementation'' and ''policy ideas and formulation'' (Howlett & Lejano, 2013: 359), then it is legitimate to focus on various aspects of banking policy design in the post-GFC era. Banking regulation and supervision have been two key policy instruments of governments. Three main

streams of research regarding banking policy design have emerged in the literature. The first stream has focused on key financial regulatory responses at the global level. The G20 and Financial Stability Board (FSB) have emerged as key transnational governmental policy networks which are at the centre of financial regulatory policy design at the global level. In addition to being a forum for central bankers and finance ministers, the G20 also became a forum for heads of states. In a similar vein, its core network, the Financial Stability Forum, became the FSB, including central bank governors and finance ministers of 19 states, the European Commission, and the European Central Bank. The representatives of the International Monetary Fund and the World Bank also participate in the G20 and FSB. As Helleiner (2010: 632) notes, ''[n]ot only was the FSB chosen over the IMF to lead international regulatory reform, but the G20 was designated by its members in September 2009 to be the 'premier forum for our international economic cooperation'''.

Policy aims and means proposed by the G20/FSB can be illustrated with a modified version of Hall's three orders of policy change. Hall (1993) offered 'first order' (i.e., changes in the calibrations of policy instruments – 'what are the specific ways in which the [policy] instrument is used?'), 'second order' (i.e., changes in policy mechanisms – 'what specific types of instruments are utilised?') and 'third order' (i.e., policy goals – what general types of ideas govern policy development?) policy change dimensions that inform 'paradigmatic' and 'incremental' policy changes (citations in parentheses are from Howlett & Cashore, 2009: 39). Howlett and Cashore (2009) called for a modified taxonomy of policy components following Hall (1993) adding (1) objectives (i.e., what does policy formally aim to address?) and settings (i.e., what are the specific on – the-ground requirements of policy?) to goals in the context of *policy aims*; and (2) instrument logic (i.e., what general norms guide implementation preferences?) to mechanisms and calibrations in the context of *policy means*. They also drew our attention to the ''directionality'' of policy change; ''what is most important is not simply the number of moves way from the status quo which occur over time, but whether these changes are *cumulative*, i.e., leading away from an existing equilibrium towards another, or whether they represent a fluctuation consistent with the existing policy equilibrium'' (Hall, 1993: 41). In so doing, they conceptualise the mode of policy change (i.e., paradigmatic or incremental) as a result of the interplay between speed (i.e., fast or slow) and cumulative directionality.

In global finance, the *policy goals* of the G20 have included promotion of international financial stability. Its key *policy objectives* have been strengthening the safety and soundness of financial corporations and the stability of the financial system as a whole (i.e., systemic stability). In regard to *policy* means, the G20 advocates strengthening micro-prudential regulation and supplementing it with macro-prudential regulation. *Policy calibrations for micro-prudential regulation* included the Basel III framework, which was designed by the Basel Committee on Banking Supervision (BCBS), the key transnational forum of bank regulators from 27 countries, in December 2010 (BCBS, 2010). In the words of a Canadian Central Banker ''the Basel III framework significantly increases the quantity and quality of capital held by banks, as well as incorporating a new countercyclical capital buffer'' (Schembri, 2014: 409). *Policy calibrations for macro-prudential regulation* included measures focusing on the pro-cyclical behaviour of financial actors. However, the general norms that guide the implementation of preferences did not change. The 'market-based approach' (Underhill, 2015) guides the *instrument logic*.

There are two main strands of the first stream of research in the literature on global financial governance in the post-GFC era. The first is focused on the role of the G20/FSB in global financial regulation. It is widely held that the G20, as a transnational government network, occupied a ''marginal position in the global economic governance'' (Knaack, 2015: 1219). This is because of major weaknesses in the design of the G20, which include reliance on memorandums of understanding, lack of authority under international law, and lack of mandate, charter and headquarters (Knaack, 2015). Consensus-based decisions of the FSB do not have a legal effect, either. These transnational public policy networks have weak organisational capacity to implement regulatory decisions, due to ''political wrangling over detail'' (Baker, 2013a: 426). Further, they also suffer from a lack of relational power over nation states to translate their financial regulatory agenda to ensure domestic implementation at the national level. In a similar vein, Davies notes that ''the problem [in global financial regulatory governance] is not the lack of global bodies [such as intergovernmental organisations and networks]; it is the absence of any hierarchy between them, or of any central body with the authority to require any of the other organisms to act, on any particular time frame'' (Davies, 2010: 185). Unsurprisingly, there has been a ''gap between G20 financial reform commitments and the reality of their implementation'' (Knaack, 2015: 1221). In addition to the G20's lack of power, distributional consequences of financial regulatory reform and formal institutional differences in financial regulation across nations have generated coordination failure, especially between the EU and the US (Knaack, 2015; Semmler & Young, 2010).

However, it should also be noted that despite these weaknesses, the G20 is still ''the premier apex policy forum'' (Baker, 2010b). It has three main powers: veto power (e.g., proposals that are collectively opposed by G20 members ''are effectively vetoed or rejected''); instigation power (e.g., it initiates ''proposals and sets broad agendas and priorities for the wider institutional complex of global financial governance''); and endorsement power (e.g., official approval of the findings of more specialist committees and forums such as the Base Committee and the Financial Stability Board (FSB)) (Baker, 2010b: 61). Further, due to its representation of the world's major powers, the G20 remains the apex organisation in global financial regulatory reform and derives its legitimacy from this representativeness (Eccleston, Kellow, & Carroll, 2015; Garrett, 2010: 20), even as its actual impact on both national and international level financial reforms or its ability to bolster the international organisations that carry out these international level reforms remain questionable (Lo Duca & Stracca, 2015; Woods, 2010). It suffices to say for now that evidence of international level policy design, especially those related to the G20, remains mixed.

The second strand of research has focused on whether there have been paradigmatic or incremental changes in bank regulation in the context of Basel III reforms. Indeed, bank capital and liquidity regulations manifest themselves most clearly in the formulation of the Basel III standards by the BCBS, although the voluntary nature of these standards impedes any efforts at enforcement. There has been wide consensus in the literature that the mode of regulatory policy change has been incremental rather than paradigmatic, and its speed has been slow rather than fast (Baker, 2013a; Begg, 2012; Helleiner, 2010; Moschella & Tsingou, 2013; Mugge & Perry, 2014: 198). Young nicely illustrates Basel III policy changes in the context of Hall's three orders of policy change (see also Carstensen, 2011). The Tier 1 capital policy represents a 'first order' policy change because it increases ''the particular 'settings' of instruments like risk-weighted capital adequacy requirements, after the widespread recognition of policy and market failure in the midst of the crisis''; the change in the 'leverage ratio' represents a 'second order' change because it ''sets a [risk-sensitive] limit on the amount of leverage that banks can have''; and liquidity coverage ratio represents a 'third order' policy change because it, with its focus on macro-prudential regulation, represents a fundamental paradigmatic shift (Young, 2014: 371). Baker (2013a,b) has argued that, despite the slow speed of incremental change, there has been a cumulative directionality, especially with regard to the growing acceptability of macro-prudential regulation, which represents a third order change (Baker, 2013a,b).

> A third order change occurs when there is a radical change in the overarching terms of policy discourse, in the hierarchy of goals behind policy, and in causal assumptions or accounts of how the world facing policymakers actually works. The movement from efficient market to macroprudential thinking represents an example of third order change according to these three criteria and in this sense it was intellectually radical (and potentially transformative) along the substantive dimension. (Baker, 2013a: 418–419; see also 2013b: 5)

However, Underhill rightly notes that a 'third order' paradigm shift in financial regulatory policy did not take place because:

> Policy failure endogenous to a pre-crisis regulatory coalition has so far failed to disturb the tenacity of material interests and therefore the ideational inertia of institutional path dependency. Despite the emergence of ideational competition from the new 'macroprudential approach' to financial governance, the market-based approach remains intact. The reforms contained in B[asel] III are still applied in a price- and 'risk-sensitive' market-based framework with no adequate mechanisms for genuine system-wide application or monitoring (2015: 470).

In a similar vein, Helleiner (2010: 631,633) notes that the ''content . . . and the governance aspect of the dominant international reform agenda has . . .been more incrementalist than radical . . .there remain many disagreements about how best to achieve specific macro-prudential objectives'' (see also Bieling, 2014: 359–360). This view has been further endorsed at the EU level that ''despite the new pieces of legislation adopted by the EU, the framework for financial services regulation and supervision in the EU is not substantially different from the pre-crisis one. The main obstacles to more far-reaching reform were political, not economic'' (Quaglia, 2013: 28).

Further, Baker (2013a,b) focuses on macro-prudential ideas and discourse only, ignoring the role of the transnational epistemic financial policy community, whose actors, ideas, vested interests and preferred institutions remain intact. As Underhill notes, ''in these networks, private market interests found respondents in finance ministries and central banks and have thus been able to shape policy at the global level'' (Underhill, 2015: 468). Hence while

macro-prudential regulations have indeed received more attention, the networks and regimes, which had driven pre-crisis global financial regulation, are resistant.

As a consequence, the policy objectives that these regimes and networks articulate remain unchanged, with any shifts in policy beliefs occurring only at the policy instruments level (Fenger & Quaglia, 2015). Therefore, in the language of policy design, a paradigmatic change would have required changes to both policy instruments and policy objectives. Furthermore, as Sheets and Pisa (2015) have noted, global coordination on financial regulation remains relatively weak, despite the highly globalised state of financial markets. Hence, while instruments of global coordination have been introduced, such as the G20 or the Basel III standards, the reality is that there has not been a corresponding shift towards objectives of global financial policy coordination.

The second stream of research on banking policy design focuses on changes in financial regulatory policies at the EU level and their implementation within the EU. In line with the G20, there have been several reforms that relate to financial regulation and supervision in the EU. These include the establishment of the European Systemic Risk Board (ESRB) and a European System of Financial Supervisors (ESFS) in June 2009 by the European Council. The general abstract policy aim was to prevent ‘‘the kind of systemic and inter-connected vulnerabilities we have seen and which have carried such contagious effects’’ (de Larosière, 2009: 6). The ESRB aimed ‘‘to form judgements and make recommendations on macro-prudential policy, issue risk warnings, compare observations on macro-economic and prudential developments and give direction on these issues’’ (de Larosière, 2009: 44). The ESFS aimed to ‘‘effectively supervise an increasingly integrated and consolidated EU financial market’’ (de Larosière, 2009: 47).

Howarth and Quaglia (2013a: 335) note that divergent ‘‘member state and industry preferences [which were] determined by a combination of political economy factors and, notably, the institutional features of the national banking sector’’ slowed down the EU’s adoption of Basel III. Unsurprisingly, there have been coordination and consensus building problems across and within nations. For example, a high number of change agents and veto players with diverse interests regarding the distributional consequences of a given reform have mobilised as supporters or opponents of the reform in order to maintain their privileged positions (Moschella & Tsingou, 2013). Bieling (2014: 347–348) argues that modest financial reforms took place at the EU level because ‘‘externally, international communication and bargaining processes have been and still are structurally biased towards a liberal global financial order owing to the strong role of global financial centres and the dynamics of competitive deregulation; and internally, the emergence of a new European economy, based on financial market integration and various processes of financialization, has brought about fundamental changes of European capitalism, as well as of societal and intergovernmental power relations.’’ In her analysis of central and eastern European EU member States, Spendzharova (2012: 328) finds that countries with a larger market share of foreign banks, and those with a political party in power that is sceptical about EU integration, have reservations about transferring regulatory power to the EU level in the context of the de Larosiere financial sector regulatory reform proposals.

Another institutional and policy response of the European Commission included the Banking Union (BU) initiative, which aimed ‘‘to create a safer and sounder financial sector for the single market’’ (European Commission, 2016). Based on a single rulebook for financial actors in the 28 Member States of the EU, key policy instruments of the BU included ‘‘stronger prudential requirements for banks, improved depositor protection and rules for managing failing banks’’ (European Commission, 2016). The BU is based on two main pillars: A Single Supervisory Mechanism (SSM) and a Single Resolution Mechanism (SRM). The European Central Bank became the banking supervisor for all banks in the euro area in 2014, under a single supervisory mechanism. A Single Resolution Board with ‘‘the powers and resources to protect taxpayers from banks’ failures’’ will be responsible for the resolution of troubled banks during a financial crisis (European Commission, 2016; Howarth & Quaglia, 2014). Howarth and Quaglia (Howarth & Quaglia, 2013b: 115) highlight several reasons to participate or not to participate in the Banking Union among EU member states.

> Among the reasons provided to support membership, participation in the SSM was seen in terms of improving the credibility of national prudential arrangements, overseen by the ECB. The ECB would possess information about the banks’ headquarters and subsidiaries, allowing more effective supervision and decision-making. Furthermore, the banking systems of the central and eastern European Member States were dominated by foreign institutions: nonparticipation in banking union might have a devastating effect on domestic banks as depositors shifted their accounts to banks headquartered in banking union Member States. There were also several reasons not to participate in banking union. Non-eurozone Member States were worried about their

second-class status, with limited decision making power as compared to eurozone members. The ECB might be less prone to focus on the risks building in non-eurozone and smaller Member States. The as yet undetermined implications of full banking union also encouraged some non-eurozone Member States to adopt a cautious position on the SSM.

They argue that varieties of national banking structures, such as the degree of internationalisation/Europeanisation, foreign bank ownership, and funding sources, influence national preferences vis-à-vis the BU (Howarth & Quaglia, 2013b). In a similar vein, Spendzharova (2014) argues that countries are most likely to preserve national regulatory autonomy when they have high foreign bank ownership and domestic bank internationalisation.

The third stream of research on banking policy design in the post-GFC era focuses on reform in informal institutions, namely the supervisory approach of financial regulators. In addition to formal institutional reforms in financial regulation, there are also informal institutional reforms that focus on micro-prudential supervision. Here financial supervision as a policy instrument is used in an implementation style. For example, as the Turner Review by the Financial Services Authority (FSA) called for, there has been a move from a light touch approach to a ''more intrusive'' and a ''more systematic approach'' in financial supervision (FSA, 2009: 88–89). In a similar vein, the IMF staff members, in a Staff Position Note, argued, ''To be effective, supervision needs to be intrusive, adaptive, sceptical, proactive, comprehensive, and conclusive'' (Viñals et al., 2010: 5). There have also been similar calls for financial supervision at the international level. For example, the Chairman of the BCBS and president of De Nederlandsche Bank noted that ''Basel III is the core regulatory response to problems revealed by the financial crisis but new rules and standards are not enough. The next critical task at hand relates to *better and more intrusive supervision at the global level*'' (Wellink, 2011: 3, italics added).

As the above discussion has shown, much has been written on financial reforms at various levels of conception. While this existing literature has sought to appraise efforts at international, regional and domestic financial reform, they have not done so from a policy design perspective. As our discussion on the policy design literature has shown, the design orientation provides a systematic and rigorous understanding of how policies are designed and formulated by examining the various design principles and processes at work. While policy fields such as climate change, water policy, social policy and healthcare, among others, have sought to incorporate a design approach to understanding the policy process, similar efforts are by and large missing in the realm of finance.

This thematic issue will therefore seek to address this lacuna in the literature. In particular, Table 2 provides a design-centred appraisal of the various financial reforms discussed above. This table is adapted from the framework that was provided in Howlett (2009). Specifically, we address financial reform at three policy levels: international, regional, and institutional. These three levels are juxtaposed with three components of policy design: policy goals, policy means, and order of policy change. The order of policy change is in turn derived from Hall (1993).

At the international level, the G20's policy goals of international financial stability have prompted efforts at strengthening micro-prudential regulations and, to some extent, macro-prudential regulations. However, and as discussed above, change remains incremental and evidence of third order change is somewhat lacking. Rather, there is a greater focus on first-order changes, especially in terms of tweaking the settings of existing financial policies. At the regional level, in this case the EU, the goal has been to manage systemic risks, as well as minimise vulnerabilities to contagion. This has involved incremental reforms to financial regulatory and supervisory processes, which again involves first order changes to the settings of the existing regulatory framework.

Table 2
Components of financial reform design.

	Policy level		
	International (G20)	Regional (EU)	Domestic
Policy component			
Policy goals	International financial stability	Manage risk and prevent vulnerability to contagion	More intrusive and systematic approach to financial supervision
Policy means	Strengthening micro-prudential and macro-prudential regulations	Incremental reforms to regulation and supervision	New financial rules and standards, e.g. Basel III
Policy change	First order	First order	Second order

Adapted from Howlett (2009) and Hall (1993).

Finally, and at the domestic institutional level, the aims of establishing a more intrusive and systematic approach to financial supervision has sparked efforts at establishing new international regulatory standards, such as the Basel III standards. This has in turn prompted the introduction of new financial regulatory instruments by domestic financial regulators. This introduction of new instruments constitutes a second order change.

While this framework can provide a useful heuristic for assessing the state of financial policy design at the international, regional and domestic level, it is by no means an authoritative way of doing so. Rather, much more conceptualisation and research is required in order that a more comprehensive framework for understanding financial sector reform as policy design can be developed. It is our hope that this collection of papers will provide a useful starting point for this ongoing conversation.

4. Conclusion

In this paper, we have sought to achieve two objectives. First, we have situated post-GFC financial reforms within the theoretical and conceptual ambit of policy design. Given the frequent citation of regulatory lapses and inefficiencies as proximate and/or direct causes of the GFC (Baker, 2010a; Claessens & Kodres, 2014; Claessens, Kose, Laeven, & Valencia, 2014; Shiller, 2012), taking a policy design approach to understanding financial reform can provide potentially useful insights into how financial regulations can be better designed. Furthermore, our delineation of financial policy design into its components of policy goals, policy instruments, and orders of policy change, provides a useful first step towards a more design-centric understanding of financial sector reform. In doing so, we hope to spark off further contributions to existing theoretical understandings of financial policy design.

This is somewhat related to our second objective, which is to provide a conceptual introduction and guiding framework for this thematic issue. While many of the articles in the rest of this issue are more focused on specific cases of financial reforms, it is useful to situate these articles within the broad conceptual framework and design orientation that we have provided in this introductory paper. We will now provide a brief description of the papers that will follow in this issue.

Howarth and Quaglia explain the divergent preferences of the national regulators of Germany, the United Kingdom, and France with regard to Basel III. They argue that the configuration of respective national banking systems – system-wide patterns in bank capital positions, and bank-industry ties, such as the non-financial companies' reliance on bank credit as an external source of finance and institutionalised bank-industry relations – shape national preferences. These preferences include national regulators' concerns for the competitiveness of their banks in international markets, domestic financial stability and economic growth. Howarth and Quaglia found that when strong bank-industry ties persist and banks are weakly capitalised, policy makers are most likely to be concerned about the effects of tight banking regulation on banking. Germany is an exemplar. When weak bank-industry ties persist and banks are well-capitalised, economic growth considerations are most likely to be downplayed in policy making on capital requirements. The UK is an exemplar. France is regarded as in-between these countries.

Spendzharova focuses on the how divergent interests of various public and private sector actors shape banking sector reforms in the EU. She introduces the 'regulatory cascading' concept to analyse the rapid successive introduction of legislative packages designed to address the problem of banks that are 'too big to fail'. She argues that ''the partial solutions to the problem of banks which are 'too big to fail' in different areas of EU banking regulation, coupled with the strategic activism of key member states such as the UK, France, and Germany, have limited the opportunities to design a coherent harmonised EU framework regulating bank structures.'' In doing so, she highlights challenges faced in policy design in complex policy-making systems.

In explaining national responses to post-crisis EU-level banking reforms, previous research has focused on banking structure (e.g., foreign bank ownership and internationalisation of domestic banks) and pro-Europeanism. Mérő and Dóra offer a new insight to our knowledge. They investigate why Hungary, the Czech Republic, and Poland opted out of the Banking Union. Based on the Hungarian case examined in a comparative perspective, they argue that these countries opted out because local politicians aimed to pursue banking nationalism, defined as ''a government policy which promotes national interest in all area of banking policy: bank ownership, bank regulation and bank supervision''.

Butzbach argues that post-GFC regulatory and policy responses at the national and the EU level ignore the links between systemic risk and banking diversity (i.e., ''the lack of heterogeneous organisational forms and business

models in national banking systems''). Drawing on the systemic risk literature in banking, the ecological literature in organisational theory, and the regulatory literature in political science, Butzbach calls for redesigning substantive policy instruments, namely micro- and macro-prudential regulation to addresses diversity-related causes of systemic risk (i.e., pro-cyclicality, interconnectedness, and commonality of assets) in banking.

A key argument of this issue is that taking a design-centric approach to financial sector reform can contribute to more effective financial sector reform and policymaking. This is especially the case with regard to policy design's emphasis on distinguishing between policy means and policy goals. Butzbach addresses this design element by arguing that existing policy means, such as macro-prudential policies, do not contribute to the desired policy goals of greater banking diversity and lower systemic risk. He argues instead for a multi-level approach comprising a mix of policy means.

However, it has also been noted that policy design in financial sector reform is often complicated by politics and hence not necessarily always a 'clean' or clear-cut process. For instance, Mérő and Dora have shown how Hungary, the Czech Republic and Poland opted out of the Banking Union as their policy preference for banking nationalism conflicted with the Union's ideals. Such differences can extend to the international level as well, as Howarth and Quaglia's contribution shows. They show how the different policy preferences of national regulators in Germany, the UK and France resulted in different approaches towards achieving Basel III policy objectives.

Further, differences between the design processes of different levels, whether national, regional or international, can also contribute to positive policy outcomes. As Spendzharova's contribution 'regulatory cascading' in EU banking reform shows, interactions among the reforms of EU member states may organically give rise to policy solutions, even in the face of incomplete or partial design at the regional level. A similar argument can be found in Travis Selmier's piece, which argues that the formation of an oligopolistic bargain between policymakers and major domestic banks in Australia, Brazil, Canada and China facilitated the promotion of financial activity and innovation by creating national boundaries, behind which these domestic banks were able to develop and flourish. In return, banks acted as stewards of their financial environments.

In other words, political networks and state-industry collaboration can be beneficial for the design and implementation of effective financial policies. This is emphasised in the contribution by J.J. Woo, M. Ramesh, Michael Howlett, and Mehmet Kerem Coban, who discuss the impacts of policy capacity and regime coherence on effective financial policy design and provide a greater emphasis on policy design. Focusing in particular on the two cases of the 1997 Asian Financial Crisis and the 2008 Global Financial Crisis, Woo et al., discuss how regime capacity can evolve and adapt by learning from past crises. More importantly, they argue that financial policy design activities are therefore bound by regime dynamics and design situations. Indeed, states, domestic actors, and institutions, as well as political economy, matter in shaping policy objectives and means, despite transnational governance networks, economic regionalisation, and globalisation processes. Indeed, as Howlett and Lejano (2013: fn.1: 317) noted, "...via the feedback mechanism in the policy cycle...tool choices led to the establishment of ''political economy'' of a policy regime: A tool choice [e.g., bank capital regulation] to achieve some end created a constituency for continuation of that incentive (and sometimes one opposed to it), affecting future policy deliberations and decisions including those related to instrument choices.''

This has important implications for future research. First, there remains a need to further explicate and conceptualise the design elements of financial sector reform. This includes greater efforts in understanding both the financial policy design process and the design situations or spaces within which such processes are situated. As the GFC has shown, regulatory shortcomings can emerge from deficiencies in both financial policy design and the political economic context within which regulations are crafted. Developing a clearer understanding of financial policy design processes and situations can work towards the design of more effective regulations as well as a closer understanding of any unhealthy state-industry relations that may result in regulatory capture.

How can we bridge the context and macro and micro level causal processes with policy design and implementation? Structure, institution and agency-based (SIA) framework offers a promising approach to investigate the interdependence of macro-level influences (i.e., institutional and structural complementarities) on micro-level actor behaviour and their interactions to explain how and why actor behaviour and socio-economic, institutional and policy outcomes occur (Bakir, 2013, 2017). The idea is that the more complementary a set of structures, institutions and policies is the better will be a corporate and a country's economic performance. As such, this interdisciplinary, multi-actored and multi-level perspective offers a useful avenue to address a pressing practical and intellectual need for a better understanding of how specific causal processes may be designed or managed in practice through aligning and

reinforcing various policies and incentives thereby producing competitive advantages for public and private sector actors, and comparative advantages for nations that would not otherwise occur.

As some of the contributions in this issue have shown, regulatory pressures, arising from transnational financial policy networks and the European Commission, tend to be filtered by domestic institutions in the national political economic context where these policies are designed by state actors. As a consequence, policies that are designed at the national level may often deviate from the policy goals and preferences of transnational and regional policy networks. This suggests an international-domestic bifurcation of the policy design space. In other words, financial policy design takes place in two levels – international and domestic – with interactions between these two levels engendering either convergence or resistance. For instance, and as the papers discussed above suggest, existing domestic policy design processes may persist *despite* pressures for reform or the design of new regulatory standards at the international levels. Conversely, and as Woo et al. suggest in this issue, it is also possible for policy learning to take place across not only different levels, but time as well. This is particularly the case for Asian financial centres that initiated intense financial reforms in the aftermath of the AFC, and through such reforms, have proven particularly resilient during the GFC. Thus there is a need to refocus research attention on the policy design process and, more importantly, the policy designer. In most cases, financial policy design is carried out by the state, or, in the case of transnational networks, coalitions of states and international intergovernmental organisations (which are essentially comprised of state representatives) working together to design new regulatory instruments and standards. There is, in other words, a need to account for the 'return of the state' in solving global policy problems. This reorientation towards state action had been stimulated by the onset of the GFC and a perceived need for closer regulation of hitherto unbridled financial capitalism.

A second avenue of future research is that there is also a need to extend this perspective towards emerging financial centres, particularly those in Asia. We recognise that the majority of the papers in this thematic issue focus on Western developed economies, particularly the EU. This is largely due to the subject expertise of the contributors and a more developed literature on financial reforms in the Western context, which can more easily be wedded to the design orientation. However, Asian financial centres such as Hong Kong, Singapore, and Shanghai are increasingly prominent in the global political economy (Woo, 2016). There is therefore a need to understand the policy design processes that drive the development of these centres. This is especially pertinent, given that these Asian cities operate under political systems that often differ from those of Western cities.

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