Received: 3 March 2021 | Revised: 14 June 2021 | Accepted: 20 July 2021

DOI: 10.1111/padm.12774

SPECIAL ISSUE ARTICLE

public administration WILEY

Neoliberalism and banking crisis bailouts: Distant enemies or warring neighbors?

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Funding information
Australian Research Council, Grant/Award Number: DP140101877; AXA Research Fund; British Academy, Grant/Award Number: MD130026; Economic and Social Research Council, Grant/Award Number: ES/K002309/1

Abstract

How should we understand proliferating government bailouts of financial firms in successive crises since the 1970s and the rise of neoliberal norms opposing such discretionary public assistance? We argue that the relationship between bailouts and neoliberalism is one of mutually reinforcing coexistence. First, a new "bailout coalition" including much of the middle class has emerged in many countries over the past century, pushing governments to deliver extensive bailouts in crises. Second, many actors, including some within the bailout coalition, view neoliberal policy norms as a useful constraint on public assistance to *other* groups. This is especially visible during foreign crises. Third, governments often manage these conflicting pressures via a strategy of institutional "conversion," adapting institutions and rules associated with neoliberalism to new purposes. This has generated rising costs, including declining policy coherence, increasing financial fragility, and rising distributional and identity conflict.

1 | INTRODUCTION

How have neoliberal economic policy norms—a set of collectively shared beliefs that enjoins governments to administer market-conforming policies—shaped policy responses to financial crises? We seek to reconcile two apparently contradictory phenomena: financial crisis policy responses have increasingly diverged from neoliberal norms, yet these norms have remained remarkably resilient. We argue that expanding crisis bailouts reflect the emergence of a new "bailout coalition," in which traditional beneficiaries of crisis bailouts (financial firms and associated corporate actors) have increasingly drawn support from the wealth-owning middle class. This coalition has reshaped policy outcomes and the institutional strategies pursued by policymakers (cf. Hacker et al., 2015, p. 184). Yet, neoliberalism remains attractive to many, even some within this coalition, as a constraint on public bailouts *of others*. As such, neoliberalism and bailouts are like mutually co-existing "warring neighbors," not distant enemies.

Two norms are central to neoliberalism: public policy should promote competition and government intervention should be limited, ensuring a dominant allocative role for markets (Ostry et al., 2016). Many actors view these norms as useful political tools to deter governments from administering policies in ways that increase discretionary public assistance to other groups (Schmidt & Thatcher, 2014). We build on these arguments in suggesting that governments have sought to balance countervailing pressures by retaining neoliberal administrative forms while supplying targeted bailouts in crises. We show that a crucial policy strategy has been institutional "conversion," which occurs when strong resistance to formal institutional reform by some groups leads reformers to seek to "repurpose" existing rules and institutions (Mahoney & Thelen, 2010; Streeck & Thelen, 2005). This repurposing has been facilitated by ambiguity in the administrative rules associated with crisis policies, which we summarize as "institutional ambiguity." We show that there has been variation in the reliance on conversion strategies, depending on the strength of opposition and the level of ambiguity. This variation is especially visible in the difference between domestic and international crisis strategies. Abroad, the bailout coalition has often lacked a strong interest in deviations from neoliberal norms, so advanced country governments have cleaved more closely to neoliberalism in their international financial policies.

At home, neoliberalism and bailouts uneasily co-exist. Certainly, neoliberal governance always tolerates some public intervention that limits market competition, such as tariffs or entry barriers. But crisis bailouts, by extinguishing market panic via blanket state guarantees and nationalizations, are extreme departures from neoliberalism with powerful consequences for markets and governance. Thus, the rising incidence of financial bailouts seems antithetical to the neoliberal project and particularly puzzling.

We suggest three reasons why this matters for public policy administration in contemporary democracies. First, the rising incidence of crisis bailouts, including recently following the outbreak of COVID-19, has reduced market discipline, increased moral hazard, heightened financial fragility, and made new bailouts likely. Neoliberal norms have therefore consistently failed to deter market and policy failure. Second, many postcrisis reform attempts to rein in bailouts lack credibility because they do not reduce the underlying demand for them. Much of the relevant literature in public administration has focused on lessons of crises for the administrative forms of financial sector governance (e.g., Khademian, 2009; Peters et al., 2011), overlooking how rising demand for bailouts has produced substantial policy convergence despite administrative divergence. Third, political conflict over bailouts has intensified, making it difficult for governments to administer financial policy effectively and in ways perceived as fair, contributing to the widespread decline in trust in government. As negative financial shocks will likely continue, including those associated with climate change, our argument suggests that governments can no longer credibly commit to bailouts being a one-off policy departure warranted by exceptional disaster.

The rest of this paper is organized as follows. The first part elaborates how the idea of institutional conversion applies to financial crisis policy and the impact of the emergence of a new pro-bailout coalition, focusing on electoral democracies. The second explains how this coalition has made its demands effective, generating a powerful and rising trend toward crisis bailouts across many countries since the 1970s while reinvigorating neoliberal policy norms. It shows how, in important cases, policy actors used institutional ambiguity to exercise discretion and to repurpose existing institutions to undertake bailouts. The third part discusses why, despite this trend toward domestic bailouts, neoliberal norms have been more influential in international financial policy. The conclusion considers some wider political, economic, and policy consequences.

2 | ACTOR DISCONTINUITY, CONVERSION AND FINANCIAL CRISIS POLICIES

According to Mahoney, Streeck, and Thelen:

> Conversion occurs when rules remain formally the same but are interpreted and enacted in new ways. This gap…is produced by actors who actively exploit the inherent ambiguities of the institutions. Through redeployment, they convert the institution to new goals, functions, or purposes (Mahoney & Thelen, 2010, pp. 17–18).[1]

This argument has three main aspects. First, these actors face obstacles to reform that lead them to opt for conversion. These obstacles can be due to the presence of influential veto players and defenders of existing arrangements, ideological polarization, and collective action and coordination problems. Second, as Hacker, Pierson, and Thelen (2015, p. 184) argue, the trigger for conversion is "actor discontinuity," where actors not involved in the creation of institutions seek to repurpose them. Third, "[p]olicies whose provisions are ambiguous and whose effects depend on interpretation and discretion offer fertile terrain for strategies of conversion" (Hacker et al., 2015, p. 189). We observe each of these three factors at work in financial crisis policymaking in recent decades.

On the first, influential groups have sought to limit the ability of fiscal and monetary policy agencies to undertake bailouts. This includes taxpayers (Rosas, 2009) as well as public sector beneficiaries who view bailouts as "corporate welfare" that threatens their own access to public resources. Creditors can also oppose bailouts if they produce inflationary pressure and threaten exchange rate commitments. Healthy financial and non-financial firms may also oppose bailouts of weaker competitors if their failure poses few spillover risks. Unleveraged and less "financialized" individuals—those less connected with financial markets due to lower levels of saving, borrowing and financial asset ownership—sometimes view bailouts of leveraged individuals and wealthier financial asset holders as unfair. In addition, neoliberal norms provide policy agencies such as central banks and regulators with a crucial rhetorical device to defend their autonomy. The US Federal Reserve, for instance, was consistently attacked after recent crisis interventions by conservative legislators who objected to quantitative easing and currency swap arrangements as generating moral hazard and inflation (Broz, 2015). The Fed's provision of liquidity support to *foreign* banks further antagonized these legislators.

For these reasons among others, the wealth-owning middle class is not a monolithic bloc with homogenous, consistent preferences. Especially in tranquil times when their wealth seems not at risk, individual members can side with financial conservatives. Even within crises, political and identity cleavages may prompt opposition to bailouts from potential beneficiaries if they fear such bailouts will benefit the "less deserving" (Cavaillé & Trump, 2015; Lupu & Pontusson, 2011; Petersen, 2012; Petersen et al., 2011). In these contexts, doctrines of "sound money" and the desirable avoidance of moral hazard and market-distorting policies can have wide appeal. Although neoliberalism is often seen by critics as privileging self-interest, it offers many voters a principled objection to the special treatment of particular societal groups or classes, while prioritizing taxpayer interests. The core neoliberal policy principle relevant here is that supply-side intervention should only be undertaken to address market failure.[2] It appeals to groups on the political right and left who oppose public crisis bailouts of large banks, other firms or particular social groups on grounds of both inefficiency *and* unfairness. Indeed, this appeal has been consistently refreshed by distributional and rhetorical contestation over crisis interventions, an instance of what Carstensen and Schmidt (2016) characterize as power "through, over and in" ideas.

In this way, pressure to limit public bailouts has accompanied a rising demand for the state to commit fiscal resources to mitigate the devastating crises that accompanied financial development. The classic "solution" was to specify conditions of public support to private firms in financial crises that would protect the financial system as a whole rather than particular firms. This was the essence of Walter Bagehot's idea of the lender of last resort (LOLR) in *Lombard Street* (1873/1962).[3] He set out how a central bank should provide unlimited cash loans during a crisis at "normal" market interest rates to private banks that are solvent but temporarily illiquid, in return for "good" collateral worth comfortably more than the loans provided. This rule did not discriminate by firm size, importance or political influence and required that insolvent firms should be allowed to fail. Bagehot's rule thus combined norms of efficiency *and* fairness, enabling central banks to stem financial panics while enforcing market discipline. In the 20th century, it became embedded in financial crisis management and remained a central formal component of neoliberal financial policy regimes since the 1970s (Fetter, 1965, pp. 257–283; Goodhart, 1999).

The second aspect of conversion is actor discontinuity. In the 19th century, when the Bagehot rule was set out, wealth in advanced democratizing countries was highly concentrated. Often the top 5% or less of wealth-owners controlled almost all wealth (Piketty & Saez, 2014, p. 839). When financial assets were at risk in severe crises, the bailout coalition was narrow by contemporary standards and largely comprised distressed banks, credit-dependent firms and a small wealthy elite.

Extreme wealth inequality fell over the 20th century as the middle-class accumulated savings, pensions and, especially after the 1970s, housing assets purchased with mortgage debt. Despite some regression in recent decades, the wealth share of those within the 50th to 90th percentiles in advanced democracies remains in the range of 25% to 40% (Piketty & Saez, 2014; World Wealth & Income Database, 2017). In recent decades, the generalized shift toward defined contribution pensions has increased the direct exposure of many households to financial market volatility. Homeownership in most democracies expanded rapidly after World War II, facilitated by the rapid expansion of mortgage finance. This "democratization of leverage" gave many households a powerful interest in functioning credit markets and the avoidance of asset deflation (Jordà et al., 2016).

For these reasons, arguments stressing rising financial complexity and interconnectedness, financial sector policy "capture," the role of particular administrative forms, or changing dominant policy ideas among policy elites risk underestimating the rising political importance of the wealth-holding middle class in modern financial crises (Johnson & Kwak, 2010; Khademian, 2009; Özgöde, 2021). Middle-class wealth, with its growing dependence on debt and its connection to financial markets (the "financialization of everyday life")[4] gave a large segment of society a historically novel stake in financial stability by the late 20th century. When labor and financial markets experience shocks, exposed households and voters now expect governments of whatever political stripe or form to intervene to protect their income, debt service capacity, and wealth. We describe these preferences as "Great Expectations".[5]

By themselves, powerful financial sector interests can face obstacles to influencing policymakers in crises (Bell & Hindmoor, 2015; Woll, 2014). But the rise of the middle class creates a tactical opportunity for them to direct government attention to the plight of voters whose vital interests are at risk. Politicians in important recent cases have responded to this tacit coalitional move, claiming that bailouts of large financial institutions were necessary to protect "average citizens" (UK Prime Minister Gordon Brown, 2008; US President George W. Bush, 2008).

The third aspect of conversion strategies is the repurposing of existing institutions and rules via the exploitation of ambiguities and discretionary powers. This differentiates it from "layering," when new rules are added to existing ones (Mahoney & Thelen, 2010, p. 16). The above-mentioned opposition to the formal institutionalization of bailout policies fostered a political equilibrium for incumbent governments that incentivized the formal retention of rules and institutions that approximate Bagehot principles, while allowing key agencies to exercise discretion in crises.

The Bagehot rule of providing emergency liquidity at "penalty" interest rates to "solvent" banks in return for "good" collateral is replete with exploitable ambiguities. In fast-moving crises, agencies cannot easily distinguish insolvent from illiquid institutions (Goodhart, 1999; Rosas, 2009, p. 23). Judgments about what constitutes good collateral are also difficult. Yet, the scope for interpretation and repurposing varies by context. In the 19th century, parliaments often assiduously monitored agencies to enforce a narrow interpretation of the LOLR (Calomiris et al., 2016, p. 51).

In the 20th century, statutory discretion widened in cases like the Bank of England and the Reserve Bank of Australia, though it remained more constrained in cases such as the United States and the European Union. Nevertheless, the level of discretion allowed the LOLR generally expanded over time as financial systems developed and became more complex, and the notion of public interest broadened. From the later 19th century in Europe, when central banks increasingly took the lead in managing crises (Grossman, 2010, pp. 89–91), discretion typically applied to the interest rate charged on lending, the nature of the collateral required, and the discount applied to it. Later, central banks would extend their LOLR role via guarantees of private sector bailouts of failing banks (such as in the Barings crisis in Britain in 1890) (Grossman & Rockoff, 2015). Initially, the US Fed's emergency lending powers were constrained to lending against a narrow range of financial collateral. After the Great Depression, it was granted new discretionary powers under Section 13(3) of the Federal Reserve Act to make emergency loans to nonbanks, and the Reconstruction Finance Corporation was given powers to inject capital (in the form of preferred stock) into prescreened national banks. This screening process also entailed the exercise of discretion.

3 | THE BAILOUT TREND AND CONVERSION STRATEGIES IN CRISES

Next, we consider how this tacit bailout coalition has made its demands increasingly effective, generating a rising policy trend toward crisis bailouts in many countries since the 1970s. We also illustrate how in important cases policy actors used institutional ambiguity to exercise discretion and repurpose existing institutions to undertake bailouts. We distinguish between the policy responses governments undertake in the early phases of crises from those taken in the peak phase, when institutional repurposing often accelerates. We also emphasize how the level of institutional conversion varies by context.

3.1 | The bailout trend

The top panel of Figure 1 maps an index of bailout intensity for most democracies in systemic banking crises since 1848, drawing on research that codes thousands of crisis policy responses in democracies since the early 19th century (Chwieroth & Walter, 2019, pp. 165–184). The index ranges from 0 to 1, with higher values representing more extensive bailouts and lower values approximating relatively market-conforming, Bagehot principles.

The top panel shows that most crisis policy responses in the 19th century and even into much of the 20th were broadly consistent with Bagehot. There are signs of a shift from market conformity toward bailouts by the interwar period, but there is a decisive trend in this direction since the 1970s as systemic financial fragility re-emerged (indicated by the number of new "systemic" banking crises per annum recorded in the lower panel). The data clearly indicate that the average trend toward more costly and extensive bailouts began well before the Global Financial Crisis (GFC), across democracies with a variety of institutional forms.

The aggregate size of bailout interventions in modern crises can be massive and varied. In the GFC, targeted public support for national financial sectors reached 80% of 2009 GDP in the United Kingdom, 27% in the United States, and 15% on average for crisis-hit advanced economies (International Monetary Fund, 2009, p. 37). Figure 1 also obscures patterns of policy escalation *within* particular crises, since it is based on a long policy window.[6] These *within-crisis* policy patterns elucidate the conversion strategies deployed by many governments in recent crises, which often escalate as crises peak.

3.2 | Limited conversion in the early phase of crises

In the early phase of financial crises, institutional repurposing is often modest. One reason is that governments and central banks have an incentive to adhere to Bagehot principles in this stage to limit the potential for moral hazard and to encourage banks and firms to issue sufficient equity as a buffer against losses.[7] A second is that there will inevitably be uncertainty about whether such equity will prove sufficient to forestall a deeper crisis. This can

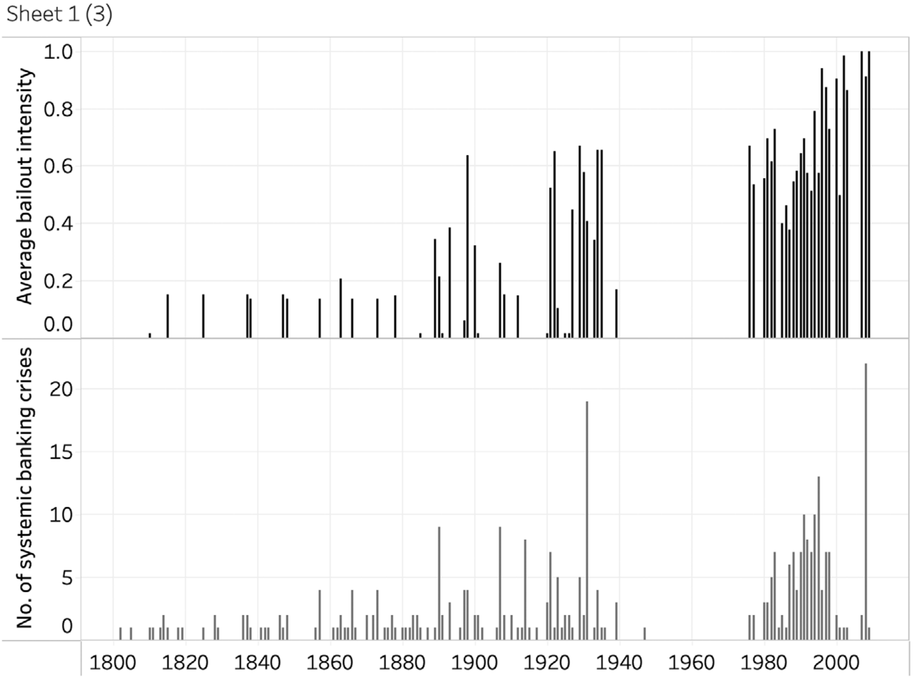

FIGURE 1 Average bailout intensity in systemic banking crises for democracies, 1848–2010. Modified from Chwieroth and Walter (2019, figure 1.2), © Jeffrey M. Chwieroth and Andrew Walter 2019. Reproduced with permission of The Licensor through PLSclear. The timing of systemic banking crises is as defined by Reinhart and Rogoff (Reinhart, 2010) before 1945 and Laeven and Valencia (2018) from 1970. Democracy codings are from Boix et al. (2014). The policy response score is the yearly average across crisis country cases of the first principal component of simple scores for extended liquidity provision, bank restructurings, deposit freezes, deposit insurance extensions, guarantees, public asset management initiatives, bank recapitalizations, and policies permitting depositor losses undertaken by governments and central banks in a window from the crisis onset year to 3 years after its end (Chwieroth & Walter, 2019, pp. 181–183). Regulatory forbearance is omitted because it is common but difficult to detect using pre-1945 sources

generate conflicting views among policy actors of the likely severity of crises and of the trade-off between avoiding moral hazard and avoiding the collapse of the financial system.[8] As Bernanke, Geithner, and Paulson remark:

> As hard as it is to predict crises in advance, it's also hard to know early in a crisis whether it's just a brush fire or the start of a five-alarm conflagration…. Responding too quickly can encourage risk takers to believe they'll never face consequences for their bad bets, creating "moral hazard" that can…set the stage for future crises. (Bernanke et al., 2019, secs. 157–159).

Third, policymakers may view early demands from financial sector insiders for assistance as special pleading that would entail significant political risks for the government, not least in terms of media coverage. In the early stage of a crisis, the weakest, most over-leveraged firms fail first, incentivizing policymakers to argue that they should bear the consequences of their folly.

Electoral and distributional considerations reinforce the political incentive to avoid bailouts in this phase (Keefer, 2007; Rosas, 2009). Initially, crisis costs fall first and foremost on shareholders of distressed financial institutions. Certainly, stock prices can fall sharply in this early phase, which can hurt middle-class households, but large falls in house prices and employment usually lag these by months and sometimes years (Reinhart & Rogoff, 2009, chapter 10). The increasing ubiquity of deposit insurance schemes since the 1980s helps to insulate households from deposit losses. So long as there is little concern that the crisis will spread to healthier institutions, asset market prices and overall economic activity, politicians often seek to limit costly bailouts to avoid being sanctioned by taxpaying voters. It also incentivizes governments to leave the early phase of crisis fighting to central banks to avoid the political costs arising from fiscal bailouts.

In sum, the political economy incentives to avoid bailouts in the early phase of modern financial crises are strong, especially in electoral democracies. To justify this stance, policymakers typically lean heavily on neoliberal policy norms. Recent examples of this tendency abound, particularly in central banks that are usually the locus of early stage crisis-fighting. In the early months of the 2007–2008 crisis in the United Kingdom, Mervyn King, Governor of the Bank of England, argued that providing extensive liquidity support to the UK banking system would undermine market discipline and should be resisted (Darling, 2011, pp. 21–23, 57, 61; King, 2016, p. 205). In the United States, early problems in the mortgage sector began in institutions like Countrywide, the leading purveyor of sub-prime mortgages. The Fed also initially held that it would be counterproductive to intervene (Bernanke et al., 2019, secs. 572–593). In neither case was this stance sustained as the crisis came to threaten the core of the financial system.

3.3 | Conversion escalation in crises

The political incentives for governments to shift to a bailout strategy strengthen as modern crises deepen, when the factors initially favoring policy caution move into reverse.[9] In this phase, financial firms' shareholder equity is depleted and new equity issuance at reasonable cost becomes difficult. Crisis escalation narrows dissent within governments and policy agencies, largely by reducing the influence of actors arguing against bailouts on principled grounds. By posing a more severe threat to household wealth and to the viability of many firms, deepening crises undermine the view that market discipline must be maintained. Compared to the early priority of minimizing moral hazard, the objective of preventing the wholesale collapse of the financial system, the economy, and household sector wealth takes center stage.

This requires governments seeking political survival to pivot rapidly. If new legislation is difficult to achieve quickly, policymakers can try to repurpose existing institutions and rules. This may also have the advantage of appearing less like a policy U-turn. In this phase, conversion strategies can come to dominate.

Intracrisis bailouts at this stage take multiple, varying forms. In addition to emergency liquidity provision (loans) to entities that are potentially insolvent, governments, and central banks can facilitate corporate restructurings (e.g., mergers of failed entities with solvent ones), impose deposit freezes that protect banks, extend the insurance of deposits beyond existing limits, guarantee the liabilities of distressed entities, purchase assets from them at generous values, recapitalize insolvent entities by injecting public funds, and exercise regulatory forbearance (e.g. by relaxing bank regulatory requirements). Such policies have become increasingly common in many countries (Chwieroth & Walter, 2019; Laeven & Valencia, 2008, 2013, 2018). Considerable public financial assistance in the GFC was in some cases also provided to nonbanks.[10] Finally, bailouts can be facilitated indirectly by fiscal and monetary policy expansions that increase aggregate demand, reduce interest rates for many debtors, and generally “lift all boats,” including ones that might otherwise be insolvent.

An illustration of this uneven shift from relative market conformity toward extensive bailouts via institutional conversion is provided in the important case of the United States over 2007–2008 (Figure 2). The crisis began in early August 2007 but months went by without substantive government action, with the Bush administration relying heavily on action by the Federal Reserve, mostly in the form of liquidity provision and monetary easing. As the crisis deepened, the discretionary repurposing of institutions and rules progressed. The Fed launched new liquidity programs that some saw as a departure from the Bagehot rule (Mishkin & White, 2016). The Term Auction Facility, launched in December 2007, lent at a nonpenalty rate. The Fed also set up new currency swap arrangements that provided US dollars to major foreign central banks to allow them to provide dollar liquidity to their own banks. In

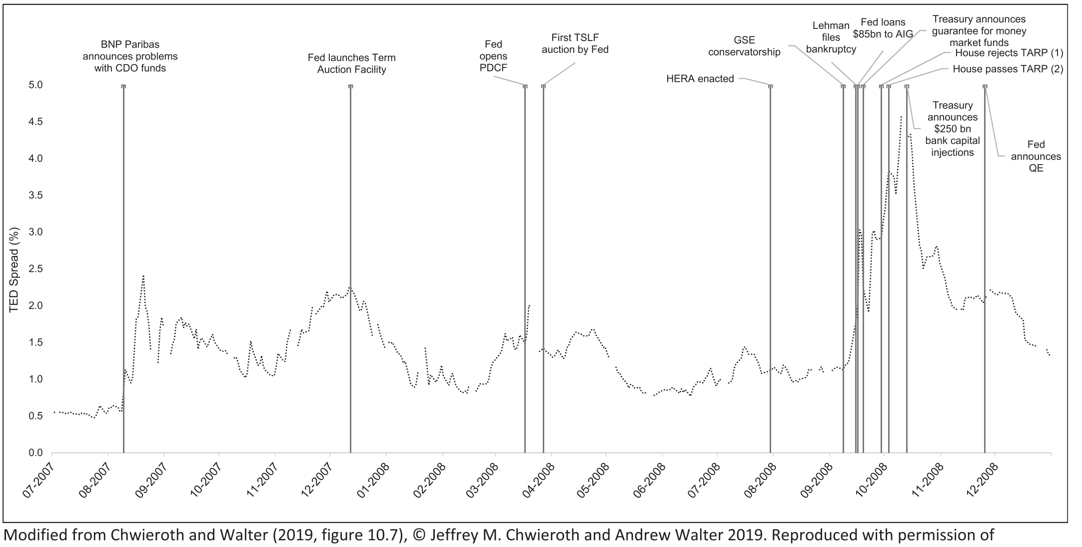

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FIGURE 2 Policy interventions in the United States, July 2007–December 2008, with TED spread (%). Modified from Chwieroth and Walter (2019, figure 10.7), © Jeffrey M. Chwieroth and Andrew Walter 2019. Reproduced with permission of The Licensor through PLSclear. The TED spread is the percentage point difference between the 3-month LIBOR US dollar interest rate and the 3-month Treasury Bill interest rate. CDO, collateralized debt obligations; FDIC, Federal Deposit Insurance Corporation; GSE, government-sponsored enterprises; HERA, Housing and Economic Recovery Act; OCC, Office of the Comptroller of the Currency; PDCF, Primary Dealer Credit Facility; QE, quantitative easing; TARP, Troubled Asset Relief Program; TSLF, Term Securities Lending Facility

March 2008, the Fed invoked Article 13(3) for the first time since 1936 to extend its liquidity provision to nonbanks, to provide a partial guarantee of Bear Stearns' assets to its acquiror, JP Morgan Chase, and to launch the Primary Dealer Credit Facility to lend more aggressively to investment banks.

During this phase, since the Fed lent in unlimited amounts to apparently solvent institutions in return for collateral, its Chair, Ben Bernanke, asserted that the Fed's actions were “consistent with Bagehot's advice”—even then a questionable characterization of the Fed's escalating crisis interventions (Bernanke, 2015, pp. 144, 148). The Fed did later resist pressure from insurers of mortgage securities, hedge funds, and Lehman Brothers for similar assistance (Geithner, 2015, pp. 145, 156). Some also attribute the Fed's and Treasury's unwillingness to support Lehman as a misjudged effort to restore market conformism following escalating departures from neoliberal norms (Ball, 2018; Tooze, 2018, pp. 176–177).

Figure 2 indicates the escalation of policy interventions as the crisis peaked in intensity in late summer 2008, as measured by the TED spread.[11] The creeping implosion of the financial system galvanized the government's willingness to embrace bailouts, but Congress remained divided. In July 2008, Paulson announced that Congress had given him a “bazooka”: a potential bailout of unprecedented scale that, in coordination with the Federal Reserve, would strengthen confidence in the Government-Sponsored mortgage agencies, Fannie Mae and Freddie Mac. He then expected, wrongly, that he would not need to deploy it.

The catastrophic collapse of Lehman Brothers and AIG in September once again appeared to create the political conditions for extensive government bailouts. Paulson subsequently wrote that only then, “for the first time I believed Congress would likely give us what we needed.” (Paulson, 2010, p. 244). After Lehman's collapse, the Fed lent to the insurer AIG $85 billion in exchange for 79.9% of its equity. The Treasury, before it convinced Congress to pass the TARP bill in early October 2008, innovated by writing a letter allowing the Fed to contribute fewer profits to the government if it lost money on the Bear Stearns deal. It deflected political opposition to the nationalization of the GSEs, despite the public examiners' assessment that they were insolvent, by persuading their regulator, the Federal Housing Finance Agency, to force them into "public conservatorship," a euphemism for nationalization. It repurposed the Exchange Stabilization Fund, intended as an exchange rate management tool, to guarantee hitherto uninsured money market funds. And the Federal Deposit Insurance Corporation (FDIC) was persuaded to guarantee all new bank debt in the entire system, extending its formal mandate of providing deposit insurance and guaranteeing the debt of individual banks.

Institutional conversion can also be seen in another important case in which administrative ambiguity is commonly thought to be low and the scope for discretion highly constrained. The European Central Bank (ECB), or more precisely, the European System of Central Banks, "are strictly limited by the prohibition on monetary financing as laid down in Article 123 of the Treaty on the Functioning of the European Union" (Calomiris et al., 2016, p. 61). The ECB is also required by statute to ensure that it receives adequate collateral when lending to private financial institutions. It may refuse to provide financial assistance on prudential grounds and place restrictions on eligible collateral, provisions that are broadly consistent with Bagehot principles.

The ever-present threat of board-level and legal challenges to ECB actions seen as outside its mandate, including within the courts of its leading member state, have also made the ECB extremely careful to justify all its actions as consistent with this mandate. The access of financially conservative policymakers and their allies to these institutional veto points have undoubtedly limited the potential for conversion strategies compared to the US case. So too has these actors' ability to draw on the neoliberal—and closely aligned *Ordoliberal*—policy norms embedded in the European Union's (EU) and national monetary constitutions (cf. Carstensen & Schmidt, 2016).

Yet, conversion has not been entirely absent. From October 2008 the ECB interpreted its mandate broadly to engage in a dramatic expansion of its support to the European financial system, going well beyond Bagehot principles. For example, the ECB provided unlimited liquidity to Euro area financial institutions at longer maturities, broadened its range of eligible collateral, undertook various asset purchase programs to inject further liquidity into the system, borrowed dollars from the Fed and provided them to European banks, and supported the provision of emergency liquidity assistance to banks by national central bank members even in controversial cases such as Greece (European Central Bank, 2018; Henning, 2017). Importantly, the ECB's shift to more extensive measures coincided with a progressive move from a "fiscal laxity" to a "systemic risk" understanding of the nature of the Eurozone crisis (Ferrara, 2020).[12] The subsequent move to establish a Banking Union—a case of institutional layering—reflected in part the recognition that the discretionary provision of bailouts during the crisis had necessitated some EU-level oversight of financial regulation and supervision to limit moral hazard.

Another example can be found in the extended Brazilian banking crises in the 1990s, where we also see a mix of institutional conversion, layering and formal legislative reform. After years of monetary turmoil, a systemic banking crisis took hold after Fernando Henrique Cardoso was elected in October 1994 and before he took office the following January. Cardoso sought to close and privatize many public banks that had been consistently used by state governments to escape budgetary constraints—a distinctly neoliberal aspect of his plan. Yet his government also sought to provide bailouts where necessary. The outgoing government had repurposed a temporary 1987 law allowing the Central Bank of Brazil (BACEN) to intervene in failing banks to nationalize two large state banks (Banespa and Banerj) in January 1995. The Cardoso government then repurposed the large federally owned bank, Banco do Brasil (BB), to support Banespa by purchasing its distressed debt. Cardoso also deployed presidential decrees extensively, including setting aside restrictions on foreign investments to bring in foreign bank capital to strengthen Brazil's financial sector (Martinez-Diaz, 2009, chapter 9). Acquiring banks were also incentivized by the provision of state-subsidized credit lines from BACEN, BB and Caixa Econômica Federal (CEF) and accelerated tax write-offs.[13]

Although the size of Brazil's middle class is smaller than in richer democracies, its participation in the financial system via housing ownership, defined contribution pensions, bank deposits, and borrowing all grew substantially after the financial stabilization associated with the 1994 *Real* Plan (Chwieroth & Walter, 2019, pp. 97–116). The much greater importance of deposit wealth for middle-class Brazilians, their high dependence on fungible wealth and credit to purchase marketized public services, and the deeply unpopular confiscation of deposits by the Collor administration in the early 1990s heightened the political imperative for Cardoso to restore the faith of middle-class and wealthy Brazilians in the financial system. The administration passed major new legislative programs to extend BACEN's and the government's authority to intervene in banks, notably the Program of Incentives for the Restructuring and Strengthening of the National Financial System (PROER) in November 1995 and the Program of Incentives to Reduce the State-Owned Banking Sector in August 1996. These programs prioritized the protection of depositors (Martinez-Diaz, 2009, pp. 91–92). This indicated rising government responsiveness to financialized middle-class interests, even while it sought to reduce the control of concentrated economic and political interests over Brazilian banks. This legislation also repurposed the Caixa Econômica Federal (CEF), a state-owned housing finance institution, to purchase PROER-intervened banks' mortgage portfolios. This greater reliance on formal institutional change in the Brazilian case compared to those mentioned above reflected the Cardoso government's relatively effective and timely crafting of a political coalition supporting reform (Chwieroth & Walter, 2019, pp. 475–485). Compared to the European case, neoliberal policy norms were also less firmly embedded in Brazil's institutions and among economic and political elites (Ban, 2013).

The Brazilian crisis underlines our broader point that policymaker reliance on different forms of policy innovation, including institutional conversion, depends on institutional context. Bailouts emerge as crises deepen and politicians improvise, with greater or lesser skill, in different settings.

4 | OTHER PEOPLE'S CRISES: NEOLIBERALISM IN INTERNATIONAL FINANCIAL POLICY

In the light of the strong trend toward crisis bailouts in democracies, including via strategies of institutional conversion, why have neoliberal policy norms been more influential in *international* financial policymaking? This divergence is puzzling, since "other people's crises" can threaten financial stability and strategic priorities in major advanced economies, whose complex financial systems have globalized since the 1970s. We identify two important political economy reasons for this divergence. The first, outlined earlier, is that there are always important domestic groups that oppose bailouts on principled and self-interested grounds. The second, which we now discuss, is that although the bailout coalition is increasingly strong in national financial crises, it is weaker in international crises. Opponents of domestic and international bailouts both have strong incentives to appeal to neoliberal norms of financial responsibility and market discipline. The composition of middle-class wealth portfolios, weighted more heavily to domestic assets, alongside lower social affinity with foreigners, heightens the attractiveness of neoliberal norms when it comes to foreign assistance (Cavaillé & Trump, 2015; Petersen, 2012; Petersen et al., 2011). When foreign crises threatened the repayment of loans to advanced country banks, Western governments supported International Monetary Fund (IMF)-led bailouts of crisis-hit countries. But this support came with conditions: structural adjustment programs that became emblematic of neoliberalism. In this way, the interests of the bailout coalition in the core countries were broadly met, while neoliberal-oriented policies abroad sacrificed the interests of foreign citizens.

This divergent approach can be seen in Western policy prescriptions in emerging country crises from the 1980s to the early 2000s. For example, key practices associated with the Asian development model, such as bank-firm-state collaboration, were subjected to harsh criticism and characterized as "cronyism" (Corsetti et al., 1999; Hall, 2003; Johnson & Mitton, 2003; Pomerleano, 1999). In whole regions like East Asia and Latin America, crises were viewed as "an opportunity to implement reforms fighting clientelism" (Vaugirard, 2005, p. 77). Crisis-afflicted governments in East Asia and elsewhere were urged to avoid bailouts and to close or merge insolvent financial institutions at least cost to taxpayers, consistent with neoliberal principles. The G7, the IMF and other international financial institutions provided loans to crisis-hit countries, but used these to pursue a major global reform agenda via conditionality and regulatory reform (Walter, 2008, pp. 8–28). An exemplar was the pressure applied by the IMF on the Indonesian government in late 1997 to enforce a strict "exit" policy for failing banks, including three linked to the ruling Suharto family (Walter, 2008, p. 58). In addition, in the early stages of this crisis, the IMF program imposed conditionalities intended to maintain "tight monetary growth" and to limit the provision of extraordinary central bank liquidity to surviving banks and firms (Government of Indonesia, 1997). These policies, supported by major G7 countries excepting Japan, which was more exposed, helped to contain financial contagion to advanced countries while intensifying financial collapse and an extraordinarily deep recession in East Asia.

Western policy hypocrisy, then, seems particularly evident in the divergence between domestic and foreign financial policy in these years. Our argument suggests why. Pursuing a stricter form of neoliberalism in other people's crises satisfies the market conformist coalition, while the domestic pro-bailout coalition was sufficiently protected. To be sure, the risk faced by the latter can vary according to the connections of domestic actors to the crisis-hit foreign country (Bechtel et al., 2014; Broz, 2005; Schneider & Tobin, 2020). Japan's higher exposure in Southeast Asian crises shaped its different stance. Major banks exposed to foreign crises can benefit from international assistance that reduces the risk of external default (Broz, 2007; Broz & Brewster Hawes, 2006; Stone, 2002, 2011). They might be joined by high-skilled "pro-globalization" workers and non-financial firms with substantial exposure to crisis-hit countries. However, the incentives for most middle-class voters to support an international bailout coalition will generally be substantially lower as long as domestic financial stability is ensured. Lower affinity with foreigners may also incline many voters to support narratives that other crisis-hit countries are responsible for "their own problems" and to prioritize their interests as taxpayers and potential recipients of their own government's largesse.

Such attitudes were visible in the Eurozone crisis from 2010, a case in which cross-border financial interdependence is unusually high. Public support in European "creditor" countries such as Germany, the Netherlands, Denmark, Finland, France and Britain—all of which had provided bailouts to their own banks since the 1990s—for financial assistance to Southern European partner countries was often weak (Brunnermeier et al., 2016; Matthijs & McNamara, 2015). In France and Germany in early 2013, only about 40% to 50% of respondents supported financial assistance to other EU countries (Pew Research, 2013). Opposition to international bailouts was particularly strong among economic nationalists among whom narratives of "lazy and profligate" Greeks and other southern Europeans were popular (Bechtel et al., 2014).

Citizens in creditor countries may not have fully appreciated how exposed their national financial systems, and thus their own interests, were to these "other peoples' crises." At the same time, survey evidence revealed that large majorities of citizens in European creditor countries expected governments to protect their own (domestic) financial assets (van der Cruijsen et al., 2013; Financial Services Authority (UK), 2012). In some exceptional cases, this political imperative could lead governments to support cross-border bank bailouts, of which the 2008 coordinated rescue of Fortis by Belgium, the Netherlands, and Luxembourg is the most notable example.

5 | CONCLUSION: THE CONSEQUENCES OF INSTITUTIONAL CONVERSION

We have argued that the rise of a wealthy and financialized middle class in democracies has substantially increased the influence of the bailout coalition in financial crises. Yet, the growing incidence of crises since the 1970s has also fed the continued resilience of neoliberal norms and their attractiveness to certain groups. Here we observe something like a "conversion corollary" to what Kay (2007) describes as "tense layering." Neoliberalism has not been formally displaced, but it has accommodated "new" bailout responses in crises at odds with its "old" core norms in a hybrid policy paradigm. It has important consequences.

First, the policy trend toward bailouts has not gone unnoticed by institutional investors and creditors, rendering promises not to repeat past bailouts less and less credible. This has reduced market discipline, increased moral hazard, and made both financial crises and new bailouts increasingly likely (Calomiris et al., 2016, p. 60). Hence, the retention of the formal institutional trappings of neoliberalism has failed to achieve the objectives of its proponents.

Second, this realization has driven many post-crisis technical and administrative reforms aimed at the restoration of neoliberal norms. Post-crisis institutional layering and formal reform have often followed intra-crisis conversion.

Prominent examples include the Dodd-Frank Act (2010) in the United States and the European Union's Bank Recovery and Resolution Directive (BRRD, 2015). This reflects attempts by governments to demonstrate to important groups their desire to minimize moral hazard and respond to taxpayer concerns about fiscal costs and distributional fairness.

Even so, the credibility of these measures is in doubt due to the ongoing strength of the pro-bailout coalition. For example, in 2017, not long after the BRRD was implemented, the Italian government set aside its "bail-in" requirements using a national interest loophole and undertook its largest bank bailouts since the 1930s (Merler, 2016, 2017; Sanderson, 2017). Similarly, one critique of Dodd-Frank by crisis policymakers was that it excessively constrained the capacity of key financial agencies to exercise administrative discretion in future crises (Bernanke et al., 2019, secs. 1725–1758). Yet it has been abundantly clear during the COVID crisis in 2020 that the Fed and Treasury were able to reprise and extend most of the emergency lending and support schemes used in the 2007–2010 period; they even added new ones (Federal Reserve Board, 2020; US Department of the Treasury, 2021). Thus, institutional reform involves a complex interplay between intracrisis repurposing of existing institutions, formal institutional reform, and ongoing exercises of discretion. In the process, neither neoliberal policy norms nor bailouts are eliminated, reflecting the uneasy co-existence of powerful forces supporting each.

Third, the distributional and identity conflict this has unleashed has become very sharp, including *within* the bailout coalition. Ordinary voters who expect the government to protect their homes, pensions, access to credit and deposits can be strongly opposed to bailing out large banks or firms, even as financialization has made the latter necessary. Within the middle class, some voters support bailouts targeted at "people like them" while opposing bailouts to others perceived as less deserving. The Tea Party movement in the United States from early 2009 is a prime example (Skocpol & Williamson, 2016). Such identity conflicts may provide support for postcrisis fiscal austerity measures, such as that pursued by the UK Conservative Party after the May 2010 election. Building on research on the impact of identity cleavages on support for redistribution generally (Alesina et al., 1999; Alesina & Stantcheva, 2020; Shayo, 2009), we conclude that the greater the salience of identity cleavages within the wealth-owning middle class, the lower the likelihood of cross-group agreement on what constitutes fair provision of bailouts and the higher the political costs for incumbent governments undertaking them.

To conclude, crisis bailouts trap contemporary governments in a policy contradiction with serious political consequences. Many have become policy schizophrenics, oscillating between neoliberal strictures in good times and toward foreign countries' crises and "crisis socialism" at home in bad times. This dynamic inconsistency is particularly visible in countries most strongly associated with the neoliberal project, where governments have gone furthest in deregulating finance, flattening progressive taxation, reforming welfare, fostering the casualization of labor markets and the rise of the gig economy, and promoting homeownership and personal savings-investment responsibilities as a citizenship ideal. Policy hypocrisy may thereby have contributed to the much-discussed growth in voter distrust of the political class.

ACKNOWLEDGMENTS

The first version of this paper was presented at the Ideas and Crisis Response workshop at the University of Melbourne in December 2–3, 2019. We are grateful to the convenors and participants in this workshop and to the reviewers for *Public Administration* for helpful comments on previous drafts that substantially improved the paper. We are responsible for any remaining errors. The support of the Economic and Social Research Council (ESRC) in funding the Systemic Risk Centre is gratefully acknowledged (grant number ES/K002309/1). This research also received financial support from Chwieroth's Mid-Career Fellowship from the British Academy for the Humanities and the Social Sciences (MD130026), from Chwieroth's AXA Award from the AXA Research Fund, from Chwieroth and Walter's Discovery Project award from the Australian Research Council (DP140101877), and from a seed fund grant from the Melbourne School of Government.

CONFLICT OF INTEREST

The authors declare no potential conflict of interest.

ENDNOTES

[1] See also Streeck and Thelen (2005).

[2] There are other norms we set aside here (Carstensen & Matthijs, 2018, p. 439).

[3] Francis Baring and Henry Thornton elaborated its main elements in the early 19th century.

[4] See Langley (2009), Pagliari et al. (2020), and Seabrooke (2006).

[5] Great expectations also modified how voters assess government performance after crises, making it more difficult for incumbents to escape political punishment. Postcrisis electoral success depends not just on the policy response, but on its perceived timeliness, quality, and fairness (Chwieroth & Walter, 2019).

[6] See the legend of Figure 1.

[7] Policies forcing the closure of insolvent banks will also minimize taxpayer costs by disincentivizing failing banks to "gamble for resurrection."

[8] For an example, see Bernanke et al. (2019, sec. 531) ("sec" refers to *locations* in Kindle versions).

[9] Unless initial modest policy measures successfully prevent the escalation of a shallow crisis into a systemic one.

[10] In the US case, for example, to broker-dealers, the insurer AIG, and government-sponsored enterprises. Outside the financial sector, insolvent automobile companies and qualifying homeowners in default on their mortgages were also supported.

[11] The temporal concentration of bailout measures continued into the first 6 months of the Obama administration (Chwieroth & Walter, 2019, pp. 389–390). The TED spread is the difference between the interest rates on interbank loans and on short-term U.S. government debt.

[12] That is, from blaming the crisis on overspending by crisis-hit countries to an emphasis on the Eurozone's institutional flaws.

[13] For further details, see Chwieroth and Walter (2019, pp. 465–474) and Martinez-Diaz (2009, pp. 78–108).

DATA AVAILABILITY STATEMENT

Data available on request from the authors.

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How to cite this article: Chwieroth, J. M., & Walter, A. (2021). Neoliberalism and banking crisis bailouts: Distant enemies or warring neighbors? *Public Administration*, 1–16. https://doi.org/10.1111/padm.12774