CHAPTER 1

Motivation and Framework

1.1 Introduction

Today, banking supervision is a common feature of the financial system in all developed countries. However, the history of formalized banking supervision differs substantially between countries in terms of both time-frame and character, and despite its importance, very few attempts have been made to compare the history of banking supervision in various countries.

Major changes in the institutional setup of banking systems, including the regulation and supervision of banks, have often been attributed to political reactions to financial crises (Grossman 2010a). The logic behind this view is that financial crises discredit the existing order of things, and politicians often respond to changed public sentiment by implementing measures aimed at ensuring that these crises will not occur again (Goodhart 2010).

While financial crises have played a key role in the formalization of banking supervision in many countries, other factors have been important in the United States (US) and the United Kingdom (UK). The emergence of formal banking supervision in the US was closely linked to the note-issuing privileges given to the national banks by the Office of the Comptroller of the Currency (Robertson 1968). In the UK, banking

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E. Hotori et al., *Formalization of Banking Supervision*,
https://doi.org/10.1007/978-981-16-6783-1_1

supervision was formalized as a result of the development of, among other things, new international financial institutions, markets, and centers in the 1970s (Capie 2010).

As Streeck and Thelen (2005) noted in the context of institutional economics, institutions tend to evolve slowly and incrementally, while rapid and overwhelming change is rare. Change is incremental because of the "bargaining" nature of stakeholders. The actions and positions of various interest groups tend to be mutually neutralizing, lessening the impact of various groups' attempts to either introduce change or retain the current institutional setup. Thus, the emergence of financial regulation and supervision should be observed over a long period of time, rather than immediately following a specific event such as a financial crisis.

The purpose of this study is to explain why the formalization of banking supervision took place at different times in different ways by identifying the drivers of formalization in the following developed countries: the US, Japan, Sweden, Germany, Switzerland, Belgium, France, and the UK. These countries display a rich variety in terms of the history of the formalization of banking supervision. The US, which was the first country to formalize banking supervision, commenced the formalization process at the state level in the 1820s and basically completed the process at the federal level in 1863–1864, providing the national banks with banknote issuing rights in relation to the newly created national currency. In Sweden and Japan, the formalization process occurred in the second half of the nineteenth century during a period of rapid economic growth, and was finalized in 1907 in Sweden and 1916 in Japan. Germany, Switzerland, and Belgium instituted a formalization process in response to the financial crisis in the early 1930s, and the effectiveness of formalized banking supervision was strengthened by different drivers over several decades in the three countries. France provides an example of a formalization process in response to the nationalization that occurred in the 1940s. In the UK, the trend toward financial globalization that commenced in the 1970s was the driver of the formalization of banking supervision.

The choice of these eight countries was motivated by several factors.[1] One of our main objectives was to present a variety of cases in terms of (a) the chronology of the formalization process (ranging from 1820 to 1970), (b) the size of the country and its banking sector, (c) the type of financial system (bank- vs. market-oriented), (d) the variety of capitalism (liberal vs. coordinated market economy), and (e) the legal system. This diverse selection enables meaningful international comparisons from an historical perspective (see Table 1.1). Furthermore, in this book, we examine the process of "formalization of banking supervision," and thus it is a necessary condition that the chosen country has important commercial banks, as well as influential government interventions, albeit to varying degrees. The US and the UK are categorized as having market-oriented systems wherein economic development has mainly been financed via the stock markets. However, the role of the commercial banks remains important in both countries, and the impact of institutional design by both governments is important in understanding the development of the national economy (Allen and Gale 2000: 30–34). The other six countries are categorized as having a bank-oriented system, with close and enduring relationships between industry and the banks with either the implicit or explicit consent of the government (Allen and Gale 2000: 34–42).

Hall and Soskice (2001: 17–21) categorized both the US and the UK as "liberal market economies," while they categorized five other countries (Japan, Sweden, Germany, Switzerland, and Belgium) as "coordinated market economies." Although France was categorized as "ambiguous," it has a "non-market coordination" system in the corporate finance sector.

[1] These include economic importance in terms of magnitude (e.g., gross domestic product) and quality (e.g., the Human Development Index score). Additionally, the choice of these eight countries is based on an historical perspective. The US and the UK are regarded as representing the Anglo-Saxon system and have traditionally been viewed as important countries, especially since the second half of the nineteenth century. Germany and France are regarded as representing the Continental system and have been influential in the financial sector since the late nineteenth century. Japan and Sweden were the earliest adopters of formal banking supervision among Asian and European countries, respectively, while Switzerland and Belgium represent smaller continental European economies and developed a highly formalized banking sector in the early twentieth century. As open economies subject to numerous European cultural and institutional influences, they provide interesting examples of the influence of various international dimensions on the process of formalization of banking supervision.

Table 1.1 Summary of the eight countries examined

Country	*GDP world rank 2018*	*GDP per capita world rank 2018*	*HDI world rank 2019*	*Type of financial system*	*Variety of capitalism*	*Legal origin*	*Supervisory authority (primary) as of 2019*	*Year formalization commenced*
US	1	9	15	Market-oriented	Liberal market economy	Common law (English origin)	FRB, OCC, FDIC, SEC	1863
Japan	3	26	19	Bank-oriented	Coordinated market economy	Civil law (German origin)	Kin'yū-cho (Japanese FSA)	1872
Sweden	23	12	8	Bank-oriented	Coordinated market economy	Civil law (Scandinavian origin)	Finansinspektionen (Swedish FSA)	1868
Germany	4	18	4	Bank-oriented	Coordinated market economy	Civil law (German origin)	BaFin	1931
Switzerland	20	2	2	Bank-oriented	Coordinated market economy	Civil law (German origin)	FINMA	1934
Belgium	24	19	17	Bank-oriented	Coordinated market economy	Civil law (French origin)	FSMA, National Bank of Belgium	1935
France	6	21	26	Bank-oriented	"Ambiguous position"	Civil law (French origin)	Banque de France	1941

Country	*GDP world rank 2018*	*GDP per capita world rank 2018*	*HDI world rank 2019*	*Type of financial system*	*Variety of capitalism*	*Legal origin*	*Supervisory authority (primary) as of 2019*	*Year formal-ization commenced*
UK	5	22	15	Market-oriented	Liberal market economy	Common law (English origin)	PRA (a part of the Bank of England)	1979

Sources GDP and GDP per capita: International Monetary Fund, World Economic Outlook Database October 2019, https://www.imf.org/en/Data, accessed on 8 June 2020; HDI: United Nations Development Programme, 2019 Human Development Index Ranking, http://hdr.undp.org/en/content/2019-human-development-index-ranking, accessed on 8 June 2020; Type of financial system: Allen and Gale (2000); Variety of capitalism: Hall and Soskice (2001); Legal origin: La Porta et al. (1998)
Note GDP ranking is based on nominal GDP in US dollars

Regarding the US and the UK, Hall and Soskice (2001: 27–31) emphasized the role of the stock market (including its function in relation to valuation and disclosure) in corporate finance in the liberal market economy, although they did not entirely discount the roles of bank lending[2] and the government in terms of macroeconomic policy.

From a legal perspective, the US and the UK are included in the "common-law tradition" ("English origin") category, while the other six countries are included in the "civil-law tradition" category. Within the "civil-law tradition" category, France and Belgium are included in the "French origin" category, Germany, Japan, and Switzerland are included in the "German origin" category, and Sweden is included in the "Scandinavian origin" category. As La Porta et al. (1998: 1151–1152) noted, law enforcement is stronger in the German- and Scandinavian-origin countries, whereas it is weaker in the French-origin countries. We will examine the applicability of this categorization to banking supervision at the time of formalization in each country.

With the aforementioned institutional economics context in mind, we focus on three dimensions in relation to the formalization of the supervision of commercial banks: (1) the legal framework (bank regulation), (2) the banking supervisory agency, and (3) bank supervisory activities. A narrative approach is adopted based on both primary and secondary sources.

Our primary data sources are collections of historical documents and archival materials. Notably, Söderlund (1976) included the confidential notes of the two directors who headed the Swedish Bank Inspection Board, while a publication by the Bank of Japan contained the minutes of the Financial System Research Committee, including arguments for the reform of the banking supervision system in the 1920s. Regarding Switzerland, we accessed a large collection of unpublished documents including the minutes of the Federal Banking Commission deposited in the Swiss federal archives. Our analysis of Belgium is also based on primary sources including the archives of the Banking Commission kept by the National Bank of Belgium and the State Archives. Regarding the other four countries, ample secondary sources in relation to the formalization of banking supervision were available.

[2] See notes 25 and 26 in Hall and Soskice (2001).

The rest of this book is organized as follows. The remainder of Chapter 1 explains several key concepts, presents a definition of "formalization," and summarizes relevant previous studies, including comparative studies. Chapters 2 to 9 trace the development of the commercial banking system and outline the history of banking supervision, mainly focusing on the formalization phase, in each of the countries studied. The countries are compared in Chapter 10 and the various drivers of the process of formalization of banking supervision are identified.

As is evident in this book, formalization of banking supervision took place in response to the shifting needs of the time, and the formalization process was incremental in many cases. In the US, formalization began in relation to the Civil War financing, while in Japan and Sweden it was closely linked to the organic development of the banking sector and the general public's increasing exposure to commercial banks as both depositors and borrowers. In Germany, Switzerland, and Belgium, the formalization process was triggered by the Great Depression in the early 1930s, although the specific forms of the crisis varied considerably among the three countries. In France, the formalization was linked to the Second World War and the subsequent control of the economy, while in the UK, progress toward financial globalization prompted a shift from informal to formal banking supervision.

Notably, although financial crises are generally considered to have been the primary drivers of major regulatory and supervisory reforms, they did not always play a key role in the process of formalization of banking supervision. In addition, it is noteworthy that from a historical perspective, regulation, and supervision have not always been "natural" responses to dysfunction in the banking system. The formalization of banking supervision was rather the product of complex political actions negotiated by relevant stakeholders with divergent interests in a specific social, political, and economic environment.

These findings are applicable not only to the design of future banking supervision system but also in the field of development economics. For example, even if a developing country experiences a financial crisis, the timing of the formalization/enhancement of banking supervision should be determined by the conditions, namely, whether there is an increasing trend in the number of depositors and whether the commercial bankers are sufficiently mature to understand the need for formalized banking supervision. Simultaneously, the country's history should be carefully considered with using the incremental change approach.

1.2 Concepts and Definition

Our theoretical approach is inspired by the terminology, definitions, and theory developed by institutional economists such as North (1990), who made an important distinction between informal and formal institutions. Informal institutions operate under socially enforced "rules" such as norms, while formal institutions are based on laws and regulations. Our interest lies in the process whereby an informal institution receives recognition, support, and active endorsement from formal institutions and organizations (e.g., government agencies).

In this book, we define informal supervision as having a discretionary, undisclosed, case-by-case, and irregular characteristic with undefined motives, targets, means, and responsibilities. Conversely, formal supervision is an arrangement whereby banking supervision is rules-based (Bank Law/Act/Decree) and sanctioned and authorized by the government, with basically the same treatment of all cases on a regular basis under formally stated objectives, powers, and responsibilities.

An important concept is that of "formalization," which is developed from a largely theoretical institutional perspective and is particularly inspired by the incremental change approach described and exemplified by Streeck and Thelen (2005).[3] This approach emphasizes the often slow and piecemeal change in institutions and the relatively rare occurrence of rapid and overwhelming institutional change. Change is incremental because of the often mutually neutralizing pushes and pulls of various interest groups aimed at either altering or retaining the current institutional arrangements. As illustrated later in this book, the formalization process is more or less incremental in every country. Additionally, in a seminal study of the literature on the history of banking supervision and regulation, White (1983) emphasized the struggle by various stakeholders to either change or retain the existing banking regulations in the US in the late nineteenth and early twentieth centuries. In this book, the main stakeholders are assumed to be the supervisor (the government), those subject to supervision (commercial banks), and those who supposedly benefit from banking supervision (e.g., small depositors). Instead of detailing the negotiation process, we deem it sufficient to outline the bargaining process among stakeholders. We assume that the interests of the general public are generally recognized by political leaders. Hence, to

[3] See also Mahoney and Thelen (2010).

attract as many votes as possible, political leaders are careful to safeguard the interests of small customers and depositors.

In contrast to other studies regarding the history of bank regulation, we go beyond merely chronicling the enactment of new or reformed banking acts. While these events are important, in many instances they are misleading in relation to identifying actual institutional change. New or reformed institutions often need active and deliberate enforcement to come into effect, which implies the need for an enforcer. As will be demonstrated later, the cases examined in this book illustrate the merits of looking at three dimensions, namely, rules, enforcers, and enforcement, in relation to the study of institutional formalization. In most of the cases covered in this book, banking supervision experienced periods when either one or two of these dimensions existed. Hence, the formalization of banking supervision involves not only the formalization of institutions (including expressing the norms, rules, and conventions of sound banking in legal form), but also the implementation and enforcement of banking regulations by regular supervisory activities executed by an organization that is formally empowered to do so. In terms of banking supervision, the state of being "formalized" is realized when (1) a legal framework, (2) a banking supervisor, and (3) bank supervisory activities are in place on a permanent basis.

Specifically, in this book, we operationalize the idea of institutional formalization in the context of the history of banking supervision by attempting to empirically capture and analyze the process that leads to the lasting condition whereby:

1) the legal basis for banking and its supervision is enacted, verified by bank acts and acts that regulate the supervision process;
2) a legitimate and empowered supervisory agency has been established, as verified by legal documents and political decisions, as well as the appointment of permanent staff and the establishment of a permanent office for in-house operations; and
3) the latter has started to enforce/implement the former on a regular basis, as evidenced by on- and off-site examinations and enforcement actions.

This book focuses on bank regulations regarding specific rules for commercial banks including the conditions for licensing (entry barrier and liability rules), the definition of banking and the scope of the banking

business (commercial/investment), capital adequacy, disclosure rules, and restrictions on interlocking directorates/insider loans (large loans). We also examine legislation in relation to banking supervision, which formally defines the objectives, powers, and resources of the supervisor. Although some forms of banking regulation such as liability rules are more or less self-enforcing, we assume that regulation requires active implementation and enforcement. As a result of this broad definition and the historical perspective adopted, we consider formalization as a long-term process, starting when one of the conditions is met and ending when all of the conditions are fulfilled.

The banking supervisor is defined as an organizational entity specifically assigned and empowered to enforce banking regulations and to engage in banking supervision as defined above. This can be an independent agency or a specific department within the Ministry of Finance (or Central Bank).

Banking supervisory activities are defined as regular on- and off-site examinations to check the health of a bank in terms of its ability to achieve one or more objectives. Depending on the objective(s), the main items to be checked will differ. Banking supervision also involves the enforcement of banking regulations through a range of disciplinary actions such as moral persuasion, fines (and/or imprisonment), or even the revocation of a bank's license.

1.3 Theory of Banking Supervision

Proper banking supervision is generally based on "principles of prudence." The Oxford English Dictionary defines the word "prudent" as "acting with or showing care and thought for the future"; its origin is the late Middle-English word "provident." In the eighteenth century, Adam Smith introduced the concept of "the virtue of prudence" as "a remedy for the vices," which is not merely a reorientation of self-interest but a reconsideration of the proper ends of a human being. Smith further introduced "magnanimity" as a complement to "the virtue of prudence" (Hanley 2009: 100–132).[4] Conventionally, the "principles of prudence"

[4]There is a guide on how to "read" Smith's *The Theory of Moral Sentiments*.

suggested that bankers should have full knowledge of the means and business of borrowers (Rae 1886).[5]

In the East, the concept of prudence existed as a philosophical tradition in relation to the "Zhongyong" (the doctrine of the average), which is one of the virtues of Confucianism, stating that one should never act in excess. In Japan, the Confucian philosopher Ogyu Sorai (1666–1728) interpreted Confucian doctrine as promoting sobriety and saving. In his well-known book "Seidan," he described sobriety and saving as essential virtues for both the sovereign (samurai) and the merchant. The noun "prudence" appeared in the earliest official English–Japanese dictionary, published in 1814. However, the concept of the "principles of prudence" for bankers was not widely recognized in Japan until the early twentieth century (Hotori et al. 2018).

Regarding prudential supervision, recent economic theory outlines why banking supervision is necessary. One key concept in explaining the need for prudential supervision is that of "externality," which developed in the field of public economics. The financial industry is closely connected through the payments system, which carries the systemic risk of "contagion." Theoretically, private costs (the costs incurred as a result of the failure of a specific bank) are lower than social costs (the costs incurred as a result of a chain of bank failures). This is called "market failure"—similar to the result of underinvestment in public goods, sound banks can fail as a result of contagion triggered by the failure of a bad bank. Additionally, the field of information economics introduced the concept of "asymmetric information" to explain the "rationality" of an excessive risk-taking strategy. Basically, information asymmetry exists between banks and customers. Although a disclosure system reduces the information gap, banks/customers are unable to access all of the internal documents or accounts of the customers/banks. Thus, information asymmetry results in "adverse selection": Good borrowers are excluded as a result of their ability to demand lower interest rates, with risk-taking banks preferring to lend to customers who accept higher interest rates and engage in high-risk business practices, while sound banks are forced to limit their lending as a result of their conservative strategy. The financial authority can impose certain regulations aimed at reducing excessive risk taking by banks. However, without proper banking supervision, the authority has

[5] Ross (1998) examined the adoption of the "principles of prudence" in the UK.

insufficient information about the banks' assets, risk status, and regulatory compliance. Hence, one of the aims of on-site bank examinations is to narrow this information gap (Goodhart and Illing 2002: 1–19; Mishkin 2001: 1–29; Goodhart et al. 1998: 1–15; Freixas and Rochet 1997: 257–279; Freixas et al. 2000: 63–84).

Another important concept in relation to banking supervision is that of "moral hazard." To lessen systemic risk and protect small depositors, a "safety net" has been introduced in relation to the modern banking system. The official deposit insurance scheme operated by the government and the "too big to fail" approach (whereby the central bank acts as the lender of last resort in the event of a bank bailout) provide a safety net. In addition to systemic risk, the mismatch in maturity dates between depositors and banks can cause a run on banks that has been likened to "sunspots," even if the banks are sound (Diamond and Dybvig 1983: 408–410). However, the existence of a safety net increases the risk of bankers' moral hazard because the depositors' level of scrutiny will decline in response to the guaranteed safety of their deposits. This is another reason for the financial authority to intervene in the financial sector. The supervisory authority constantly conducts examinations and supervision of banks to monitor the banks' performance. Imposing penalties such as fines reduces the risk of bankers' moral hazard.

Fundamentally, a regulatory system should include incentives encouraging banks to comply, otherwise banks relinquish their right to self-manage risk and must depend on the supervision of the regulatory authority. Hence, formal regulation should provide incentives for the bankers themselves that encourages voluntary risk management. Mishkin (2001: 13–15) pointed out the shift from a conventional "regulatory approach" to a prudential "supervisory approach" after "financial innovations" had facilitated the placing of "huge bets" by the banks, with the focus shifting from detecting financial crimes or breaches to maintaining sound banking business practices and proper operations. Thus, discretionary financial supervision is considered important in minimizing regulatory evasion by banks.

The economic theory underlying banking supervision lacks an historical perspective, which we address in this book.[6] Bankers' skills and knowledge of the banking business have increased over time, but banking

[6]We do not intend to criticize existing economic theory. Rather, we apply the theory from an historical perspective.

supervision cannot be effective until bankers have sufficient knowledge about the principles of prudence and banking operations. Similarly, a disclosure system only works when neither accounting fraud nor bookkeeping mistakes exist. Thus, not only moral hazard but also the maturity of bankers in terms of their knowledge and experience should be considered. In this respect, legislation regarding the formalization of banking supervision (as well as bankers' opinions in relation to the process) provides information that can be used to assess the stage of the process of formalization of banking supervision.

The emergence of ordinary customers/depositors is also an important factor. Until countries reached a certain stage in their economic development, commercial banks mostly catered for monarchs and privileged merchants. However, as the economy developed, commercial banks were increasingly used by small customers (both borrowers and depositors). As the degree of information asymmetry between banks and their customers increased, the introduction of formal banking supervision was sought by various stakeholders including bankers, customers, depositors, and stockholders. Thus, the level of social and economic development should be examined as one of the barometers of the formalization of banking supervision. The relationship between the commercial banks and the government is another important factor. Historically, commercial banks were permitted to issue their own banknotes, underwrote huge amounts of national bonds, and were deeply committed to national development projects. Thus, the soundness of these banks was crucial for the government's credibility, which more or less provided the rationale for the formalization of banking supervision.

1.4 Scope

This book focuses on identifying and explaining the formalization of banking supervision from an institutional perspective and places less emphasis on the effects and quality of the supervision itself. Additionally, we are mainly concerned with the shift away from an informal system of banking supervision, and thus we do not address informal banking supervision in detail. Of course, in every country in which a banking sector has developed, some form and level of informal banking supervision developed simultaneously. The creation and operation of a bank automatically attract stakeholders with various incentives in relation to

monitoring such things as proper conduct, fair treatment, and remuneration. This informal supervision still prevails today, being undertaken by shareholders, employees, analysts, the media, depositors, and customers, although the development of a formal regulation system has reduced these stakeholders' incentives. Even formal supervisors make use of informal supervision to complement the laws that regulate financial companies. Similarly, the process whereby individual banks/banking associations monitor their own/members' legal compliance, namely, self-regulation, is not examined despite its importance in several countries.

This book deals specifically with the supervisory system in the commercial banking sector. Despite its significance in some countries, the supervision of financial intermediaries other than commercial banks is not systematically addressed. Several elements, such as the inspection of finance companies, are not included, even if they were established before the process of formalization of commercial banking supervision began. For example, in the case of Germany, we do not include the supervision of mortgage lending institutes (Hypothekbanken) that commenced in 1899 at the national level.

Because banking supervision was formalized at different times in the eight countries we examine, the periods covered differ in relation to the various countries. Regarding the US, we focus on the supervision of commercial banks at the state and federal levels for about 80 years from the mid-nineteenth century.[7] In relation to Japan and Sweden, we mainly examine the period from the late nineteenth century to the early twentieth century, while for Germany, we focus on the period commencing with the Great Depression in 1929. In relation to Switzerland and Belgium, we mainly study the period from the 1930s to the 1970s, which witnessed the enactment and progressive enforcement of commercial banking laws. In the case of France, we examine the period following the implementation of the Banking Act of 1941, while regarding the UK, we mostly examine the formalization process following the secondary banking crisis in 1973–1974. Overall, the period studied extends from the early nineteenth century to the late twentieth century. We do not deal with the Basel Committee on Banking Supervision (except for the UK chapter), since the influence of international institutions over national banking supervisory arrangements increased from the 1970s, in particular.

[7]We note that the multi-agency and multi-level arrangements for commercial banking supervision in the US present a challenging case in terms of both comparisons with the other cases and our concept of formalization.

1.5 Previous Research

The growing body of literature on this topic suggests that the formalization of banking supervision has been triggered by different factors in various countries. The existing literature on each of the eight countries we examine is discussed in the Introduction to each country's chapter. However, the following paragraphs provide an overview of the literature on the formalization of banking supervision, with a special emphasis on comparative and internationally oriented studies.

Banking supervision in the US has been the subject of numerous academic studies (e.g., Mitchener 2005, 2007; White 1992, 2009, 2011). It is well known that formal banking supervision has existed for nearly 200 years in the US. Mitchener and Jaremski (2014: 7–13) confirmed that the state of New York introduced formal banking supervision in 1826, while Robertson (1968: 33–86) detailed the beginning of banking supervision at the federal level via the Office of the Comptroller of the Currency in 1863–1864.

In contrast to the long history of banking supervision in the US, formalized banking supervision in the UK only commenced in 1979 with the enactment of the new Banking Act (Norton 1991: 7–17; Capie 2010: 587–631). As Schenk (2014) and Mourlon-Druol (2015) noted, the formalization process in the UK was accelerated primarily by the need for international banking supervision that was triggered by the Herstatt Bank crisis in 1974, and the secondary banking crisis in London in 1974 revealed that the domestic system was vulnerable as a result of lax supervision. Thus, the US and the UK are polar opposites in terms of the history of banking supervision.

Previous studies have reported that formal banking supervision was introduced to other European countries during the Great Depression. For example, Germany began the process of formalization of banking supervision in response to the banking crisis during the Great Depression, with the emergency arrangements of 1931 being formalized in 1934 (Bähre 1984). Similarly, the Netherlands commenced the formalization process in 1932 (Mooji and Prast 2003), while Switzerland and Belgium did so in 1934 and 1935, respectively (Giddey 2014), and Italy introduced a new banking law in 1936 (Barbiellini and Giordano 2014). Furthermore, previous studies involving multiple countries (Zahn 1937; Allen et al. 1938; Smits 1940; Gigliobianco and Toniolo 2009) have found that many developed countries introduced, enhanced, or at least considered formal

banking supervision during the Great Depression. The 1930s represent a watershed in the institutional and administrative history of many developed countries, in particular regarding state intervention in the economy (Cassese 1984). Thus, it appears that the triggering of the formalization process by a financial crisis is a familiar pattern.

The history of banking supervision in Japan and Sweden has also been the subject of several studies. Hotori (2006) first focused on the history of banking regulation and supervision in Japan and identified various objectives and functions. However, while that study described the role of formalized banking supervision in the 1920s and 1930s, the formalization process itself was not examined. The history of financial regulation in Sweden has been examined in studies of the regulatory changes that occurred around 1900 (Fritz et al. 1989; Larsson 2010). However, these studies provided few details on the nature of the supervisor and the banking supervision process. Wendschlag (2012) examined the institutional and organizational development of the banking and securities supervision process up until the early 1990s, although the payoff structure behind the formalization of banking supervision was not presented. Recently, Hotori and Wendschlag (2019) compared the early histories of commercial banking supervision in Japan and Sweden.

Few other comparative studies have been conducted in relation to the history of banking supervision in various countries. Drawing on cross-country compilations of banking laws (Zahn 1937; Allen et al. 1938), Ortino (1981) provided the first descriptive account of the differences and similarities between four countries' decrees on banking from a legal perspective. Grossman (2010a: 128–168; 2010b: 131–136) attempted to identify new criteria to classify financial supervision systems in various countries by surveying the temporal sequence of central bank creation and banking supervision. While that study is clearly thematically related to our study, only a fairly brief narrative account is provided as a result of the focus on the introduction of various legal acts as an indicator of change. Grossman's approach differs from ours in that the enforcement of financial regulations and the supervisory activities themselves are not scrutinized. Goodhart (2007) had a similar motivation to ours, albeit mainly focusing on the role of the central bank and limiting his enquiry to the macro level, while Hall (1993: 175–187) analyzed the differences among the Japanese, UK, and US banking supervision systems in the 1980s. Busch (2009), drawing on four case studies (the US, the UK, Germany, and Switzerland), explored the political processes that led to changes

in banking regulation during the last three decades of the twentieth century. Haber (2008) compared the development of banking regulation in the US around 1800 and Mexico in the decades around 1900, linking the chartering of banks (as a way of promoting or preventing market entry) to the political institutions in each country at the time from the perspective of promoting or preventing political competition. That study is highly relevant because it identifies multiple problems regarding the use of informal rules and gatekeepers (political cronies in the case of the US) and the gradual acceptance of formal institutional solutions to enable market development.

This book is also an attempt to fill the gap that exists between previous studies based on a domestic perspective and those based on a comparative perspective.

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Commencing with Chapter 2, we trace the process of formalization of banking supervision in each of the eight countries examined with an emphasis on the stages passed through and the timing of the "full" formalization of banking supervision based on the three aforementioned criteria: (1) commercial banking regulation as the legal basis for supervision, (2) the creation of an agency/organization empowered to enforce the banking regulations, and (3) the enforcement power or actual enforcement activities of the agency/organization. The latter is assumed to have occurred when the supervisory agency exercises regular on-/off-site examinations and is empowered to impose formal sanctions in the case of a breach of the regulations.[8]

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[8]Hereinafter, we refer to bank acts and reforms of significant importance in relation to the formalization of banking supervision rather than providing details of the banking regulations.

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