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Charles W Calomiris and Stephen Haber, *Fragile by Design: The Political Origins of Banking Crises and Scarce Credit*. Princeton University Press: Princeton, NJ, 2014; Hardcover, 584 pp.: 9780691155241, RRP $35.00 | £24.95; Paperback, 2015: 9780691168357, RRP $19.95 | £13.95 | Also available as e-book.

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Some argue that the Global Financial Crisis (GFC) was to a large extent a banking crisis. In its aftermath, it seems only logical to investigate the possible political origins of any banking crisis and subsequently scarce credit. *Fragile by Design* by Charles Calomiris and Stephen Haber does exactly that. Primarily, they address two questions: (1) why some countries are so prone to banking crises, and others not and (2) why some countries have banking systems that fail to provide broad access to credit. Calomiris and Haber argue that it is politics, the 'rules of the game', that explains why banking crises occur. They emphasise the role played by coalitions among different interest groups in society in determining the functioning of banking systems, which in turn affects financial stability and the breadth of the provision of credit. Calomiris and Haber refer to this as the 'Game of Bank Bargains'.

The concept of the 'Game of Bank Bargains' is explained in most detail in Chapter 2, and it refers to how coalitions of interest groups in society form to influence who benefits from the functioning of a banking system. For Calomiris and Haber, the property rights system underpinning the operating of a banking system is the result of political deal making, rather than some sort of 'passive response to an efficiency criterion' (pp. 12–13). The conflicts of interest inherent in the relationship between a government and banks mean that it is not possible for a banking system to perform in the best interest of all parties, although Calomiris and Haber argue that banking systems in liberal democracies come close. This is a result of the limitations that liberal democracies put on political

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populism, which reduce the likelihood of credit being channelled to the government's constituents. Of course, according to the authors, liberal democracies vary in their ability to limit populism; indeed, their central argument as to why the GFC occurred is that it was the result of the allocation of credit in the US housing market to meet political ends.

Chapter 2 also considers how the 'Game of Bank Bargains' plays out in other political systems. Compared with banking systems under liberal democracy, in populist democracies, banks tend to face greater pressure from the government to allocate credit to its constituents. This allocation of credit on political rather than financial grounds tends to result in a more unstable banking system as debtors are likely to be less reliable in paying their debts. Autocratic regimes also tend to have banking systems that allocate credit on political grounds, usually to political insiders, but such banking systems tend to be smaller as there is higher risk of government expropriation of bank assets, making citizens less inclined to deposit money in a bank. Figure 2.1 (p. 42) provides a helpful summary of what outcomes for the financial system Calomiris and Haber see resulting from a range of different types of government.

In Chapter 3, the authors chart the concomitant development of banking systems and nation states within Europe, beginning in the 16th century. They argue that the development of nation states and banks was symbiotic. In their words, 'states made banks, and banks made states' (p. 83). A small problem in this chapter is that they wrongly attribute a financial innovation developed in the Middle East to Europe. In their discussion of the invention of bills of exchange (pp. 72–73), they do not mention that bills of exchange known as *suftajas* were in use in the Middle East as early as the 11th and 12th centuries, much earlier than they were used in Europe, albeit in a simpler form (Goitein, 1967: 243–245 in Abu-Lughod, 1989: 223–224).

Much of the rest of the book is made up of case studies of banking systems, said by the authors to be 'representative'. While case studies are much more accessible to the lay reader than other approaches which rely more on statistics, such an approach only allows the reader to understand how crisis-prone a banking system is and why, but it does not allow analysis of underlying trends such as may help predict future financial crises.

In Chapter 4, Calomiris and Haber examine the development of England's banking system and the role that it played in the early development of British Empire. They argue that by establishing the Bank of England as monopoly lender to the government, the UK was able to wage war more cheaply than other European states. In Chapter 5, the authors provide a sweeping history of the English banking system from the 19th Century to the present. Although this chapter was quite enjoyable to read, it devotes only a couple of pages to the GFC's effects on the UK. Arguably, this reflects a shortcoming in their emphasis on the role of political bargain making – understanding such bargains is revealing insofar as the frequency of financial crises is concerned, but not particularly revealing about financial crises themselves, demonstrating that the authors have not set out to explain the GFC.

The history of the banking system of the United States from pre-revolutionary times to the 1990s is covered in Chapter 6. According to Calomiris and Haber, throughout most of this time period, the USA's 'Game of Bank Bargains' was dominated by a coalition of agrarian populists and unit bankers. The authors argue that the system of unit banks was particularly unstable because of the inability of unit banks to spread risk, but was

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favoured by farmers because local monopoly banks had no choice but to provide credit even in bad seasons.

The authors track the development of a 'new US bank bargain' characterised by a coalition between unit banks wanting to merge and urban activists agitating for increased access to housing for households with low incomes in Chapter 7. This chapter is particularly interesting in that it lays out what Calomiris and Haber see as the foundations for the subprime mortgage crisis that emerged in the mid-2000s. The liberalisation of US financial markets in the 1980s led to a wave of bank mergers in the late 1980s and throughout the 1990s. The authors emphasise that, in order for banks to merge, they needed to be seen by the Federal Reserve as good corporate citizens, a requirement that they have fulfilled by providing greater levels of credit to low-income households who were more likely to default.

Chapter 8 examines the litany of regulatory failures seen in the US mortgage market up until the GFC. According to Calomiris and Haber, the crisis was partly due to ineffective prudential regulation. They argue that the Federal Reserve and other regulators could have acted to prevent the crisis, but in doing so, they would likely have precipitated a politically unpalatable credit crunch, which could in turn have led to Congress undermining the independence of the Federal Reserve. However, this argument was unconvincing, as failing to avert a crisis that was obvious with hindsight is arguably just as likely to result in the interference of Congress. As with Chapter 5, there were only a few pages here devoted to the GFC itself.

In their examination of the Canadian banking system in Chapter 9, the authors conclude that British attempts to curtail the political power of French-speaking Canadians led to a centralised banking system in a centralised federation (pp. 296–297). The Canadian banking system is characterised by nationwide bank branching with bank charters that need to be renewed periodically by the Canadian legislature. This provides Canadian banks with a strong incentive to behave in a responsible fashion to ensure that their charter is renewed.

The Mexican banking system from the nineteenth century to the present day is the focus of Chapters 10 and 11. Mexico's banking history provides strong support for the author's arguments that dictatorships or the absence of a functioning state lead to poor banking outcomes. In the period discussed, Mexico experienced two internal armed conflicts, during which time expropriation of bank assets was widespread, resulting in tiny banking systems. In the same period, Mexico experienced two dictatorships, under Porfirio Diaz (1876–1911) and the Institutional Revolutionary Party (PRI) for most of the 20th century. The results for the Mexican banking system were much the same in both cases: the banking system was relatively small and provided credit to insiders, although in the latter regime, credit was provided to the masses of PRI voters rather than just elite members of the regime. In particular, I found the discussion of Mexican bank privatisation in the late 20th century to be interesting. The ways in which the PRI inflated the value of banks that they had expropriated not 10 years earlier were as shocking as they were compelling.

In Chapters 12 and 13, Calomiris and Haber focus on Brazil's experience of weak autocratic leadership giving way to populist democracy, beginning in 1808. They argue that aspects of Brazil's geography, mainly the separation of settlements by hundreds of

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kilometres of jungle and strong coastal currents making sea transportation difficult, predisposed the country towards having a weak central government. High inequality resulting from the colonial planter economy, combined with weak governments, meant that neither the rich nor the poor could be taxed appropriately, without risking overthrow of the government. As a result, Brazilian governments up until the 1990s conducted a policy of printing money to fund deficits, that is, they relied on inflation taxation. Eventually, such high rates of inflation led to a series of democratic reforms in the 1980s and 1990s. Calomiris and Haber are mostly optimistic about the future of the Brazilian banking system, although they conclude that the populist currents in Brazilian politics could well lead to a crisis similar to the US subprime mortgage crisis.

In Chapter 14, Calomiris and Haber 'travel to other places' to determine whether their sample is representative. In doing so, they argue that it is 'high time to restore a balance to social science' (p. 452) through the use of more narratives and less statistics. They continue by determining that their chosen countries are statistically representative, before considering countries that a sceptical reader could consider exceptions to their model. Although they would say to such a reader that an exception does not disprove a trend (pp. 462–463), it seems quite possible that Chile might be an exception, despite their arguments to the contrary. Under the dictatorship of Augusto Pinochet, Chile's bank credit relative to gross domestic product (GDP) grew from 5% in 1975 to 41% in 1990 (p. 473). Owing to lack of research on this topic, Calomiris and Haber are only able to hypothesise that this was possible because Pinochet was able to convince the population that his dictatorship was not a threat to their financial assets, but that the threat was instead the preceding left wing government (p. 476). Given the brutality of the Pinochet regime as well as the length of time Pinochet governed, this is hard to believe.

In the concluding chapter to the book, Calomiris and Haber discuss a broad range of differing explanations for banking crises. They are critical of libertarians who think that the banks do not need the state, but also of what they call 'partisan finger pointing' at individuals and groups such as 'greedy' bankers for being responsible for crises.

Overall, this is a book well worth reading for those who have even a cursory interest in financial crises and banking systems. Because it does not delve into the GFC in much detail, focusing on its antecedents, it is more for readers with a general interest in banking and financial crises than for those looking to better understand the recent crisis specifically. While the focus on the role of politics was refreshing, it is clear that politics cannot explain everything about financial crises. Although Calomiris and Haber's 'Game of Bank Bargains' provides an interesting perspective, financial and econometric models are still better placed to explain the dynamics of financial crises as they unfold. Nonetheless, Calomiris and Haber's intention of restoring balance to the social sciences through the greater use of narratives is admirable in being accessible to a wide readership. Given Asia's increasing prominence in the global economy, it would have been good to see an Asian economy feature in the book, but this absence of an Asian economy does not undermine the book's value.

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