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Financial actors serving the common good

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PANEL B "Financial Actors Serving the Common Good"
Prof. Dr. Marcelo F. Resico

First of all I would like to thank the organizers for the invitation to such a qualified panel.

Posing the topic: "Financial actors serving the common good" today, is directly related to the lessons we draw from the recent financial crisis. To review the case I understand two points need to be addressed briefly: on one hand, a diagnosis of the crisis, and on the other, the proposal for an efficient and resilient financial sector that follows from that view.

Concerning the diagnosis, I agree with those who affirm that the crisis was originated by an excess of savings formed in financial markets for various reasons.[1] This excessive volume of savings caused mal-investment, and evolved in accordance to the pattern of what we can call a "speculative bubble", which is not such an infrequent phenomenon in the functioning logic of capital markets. I think that the world economy during the 90s and 2000s has been characterized by an immoderate optimism regarding the potential self-regulation of capital markets. This situation was based on two elements: on one hand by the technological revolution that provided powerful new tools, and on the other, by a consensus in economic theory and policy which led to financial deregulation and gave excessive operating margins without adequate supervision.[2]

Although the savings glut is always linked to monetary factors, it is arguable that this factor contribution was not decisive to the crisis. In accordance with this point it is possible to distinguish two periods: the first one comprising the 70s and 80s, characterized by significant derangements leading to inflationary crises in many countries, the second period, during the 90s and 2000s, characterized by lower inflation and price stability based, in general, on better macroeconomic policies. However, in this second period the crises in the financial markets were increasing in frequency and depth.

If we focus now our attention briefly in the key factors underlying financial deregulation –due to the scope and length of this presentation– it could be argued that they consisted in the reversal of several principles harshly learned during the Great Depression of the 30s, which generated a relatively stable system after World War II, and were abandoned in the last 30 years. Particularly significant was the rejection of the separation between the banking and the stock market sector.[3] The importance of this point is that the banking sector became again locked to the operational risks of capital markets, including "bubble type" behavior.

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[1] Beside the own evolution of financial markets, addressed in this statement, other important causes of the saving glut were cyclical macroeconomic behavior increasing profits during the boom period, higher inequality of income distribution and the development the *global imbalances*.

[2] Marcelo F. Resico, "Crisis en la nueva economía", *Revista Valores*, No. 55, December 2002.

[3] At this point it was important the repeal of *Glass–Steagall Act* of 1933 with the *Gramm–Leach–Bliley Act* of 1999 at the USA, just before the most significant crises of this stage.

Parallel to this event, we observed the abdication to regulate the new financial instruments, created by financial innovation, resulting in the so-called "shadow banking", which also increased the risk supported by the system. Another kind of deregulation came from the change in orientation of the economic theory and legal practice of anti-trust and competition systems, which criticized and reduced the effectiveness of these policies over the last 30 years.[4] This last development contributed to the consolidation and concentration in the banking sector and other financial institutions, creating what we now know as "too big to fail" entities. These developments led to greater fragility in the functioning of capital markets and to higher probability of contagion to the banking sector compromising the whole system.

Regarding the proposals, a return to sound financial regulation is needed to prevent "contagion effect" or "domino effect" from the capital market to the banking system. This objective could be obtained through the separation of investment banking from commercial banking. Other relevant measures to reduce systemic risk are requesting information disclosures and regulation of new financial instruments, monitoring systemic risk and fostering effective competition. In this context, it is important to discard the narrow utilitarian view that only economic performance is important, regardless of other objectives. Beside economic performance there is a need, among others, for solidarity and a reasonable degree of stability.

Considering international coordination to address the problem, although it is widely accepted that there are blind zones to national regulations, created by globalization, there have been clear setbacks and shortcomings at this level. In this sense, the first step is the reversal of these trends nationally, and there are signs that this is being implemented to some extent nowadays.[5] Regarding the global sphere to foster coordination, most probably, the right approach is to improve existing institutions, bettering the systems of representation and governance, and fostering consensus in the points already exposed. This task is *per se* a big challenge because it is difficult to get the necessary consensus and reliable fulfillment on the part of the actors, especially in our time signed by dynamic geo-political and geo-economic changes.

To conclude I would like to stress that it is important not to forget that the solution can not only be relied on to rules or organization, but that it imposes an ethical and cultural change. From the culture of quick success, instant gratification and confidence in money, prevalent in some areas, we need to reinforce the recovery of achievement through work, responsibility and a transcendent vision of human goals. Without a significant change at this level, the proposed measures effectiveness will be limited and we could run a higher risk of a crisis recurrence.

Thanks for your attention.

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[4] Kovacic, W.E. and Shapiro C. “Antitrust Policy: A Century of Economic and Legal Thinking,” *Journal of Economic Perspectives*, Vol.14, No.1, Winter 2000.

[5] For example the *Dodd–Frank Wall Street Reform and Consumer Protection Act* signed into law by President B. Obama in July 2010, which finally included the so called *Volcker Rule*.