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Beyond Europe's financial bifurcation point: Policy proposals for a more stable and equitable financial system

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Map

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2. The past and present of banking in Europe
3. Approaching a bifurcation point in European finance
4. A sustainable banking future in a feasible Europe
5. Policy proposals for more stable & equitable finance

1. Introduction & overview

- The financial system in Europe both reflects the effects of three decades of worsening inequality and operates in ways that it deepens it.
- The largest and most sophisticated institutions in this system have not cushioned the economy from crisis; they have fed crisis and then absorbed scarce public resources for fear the system would collapse.
- Following: a proposed list of reforms for addressing the inequality-finance nexus in Europe.

Reform of European banking and financial market regulation

1. Eliminate excess financial risk-taking.
2. Rein in the activities and size of too-big-to-fail megabanks.
3. Gain regulatory control of shadow banking and offshore financial tax-havens.
4. Limit destabilizing interconnectedness across national borders.

Structure and functioning of European banking and financial markets

5. Encourage pluralistic banking systems to better meet local needs.
6. Retool the European Investment Bank (EIB) to better facilitate European economic and social development; and create national development banks as strategic allies of the EIB and of national governments.
7. Reform the mandate of the European Central Bank (ECB) to include employment targets, and make the ECB democratically accountable.
8. Rethink the forms, extent and terms of Europe's financial integration with financial centres and firms in the rest of the world.

The financial rights and financial security of everyday Europeans

9. Set trans-European limits on predatory lending.
10. Establish the concept of financial citizenship for Europeans.

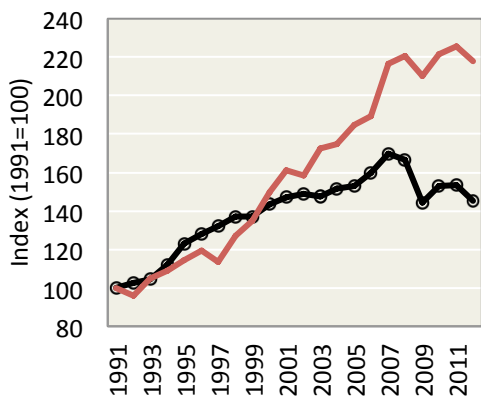
2. The past and present of banking in Europe

Europe has financialized on a wide-scale basis, almost across the board. But since 2008, financial crisis and austerity policies have created a toxic global trajectory of stagnant growth, redundant and insecure labor, widening inequality, and asset-market bubbles.

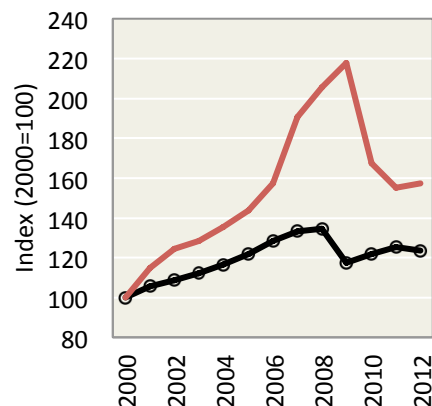
- The behavior of megabanks and shadow banks led to the collapse of leveraged subprime securitization (2007), compromised global liquidity, and forced the use of scarce public resources to prevent collapse. But in a highly financialized economic space, what is the alternative?
- So, the banks were rescued, but:
 - Credit is unavailable for small/medium businesses; for households, predatory lenders are moving in
 - Housing markets have stabilized only via Death-star moves: in Spain and Greece, hedge funds and others are buying housing on speculation; the UK is seeing a housing bubble, and Ireland is seeing unpayable housing debt.

Figure 5. Gross value added of financial service and manufacturing sectors, selected European countries, 1991-2012

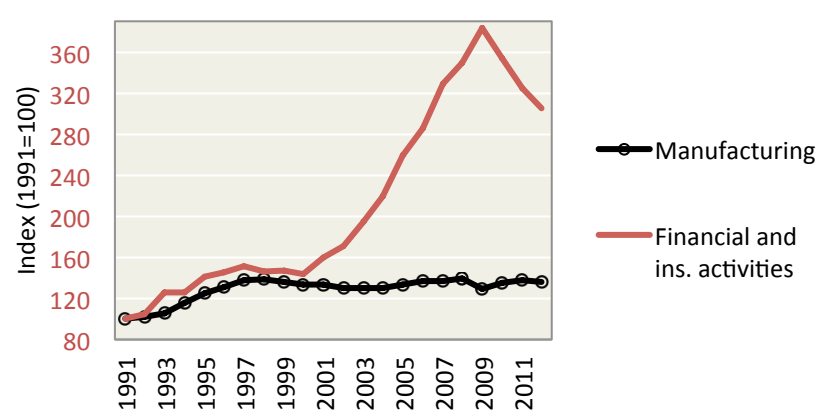
Italy



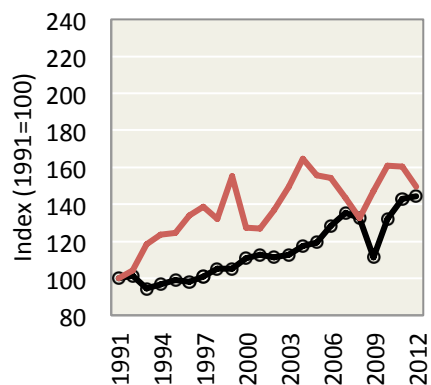
Spain (2000=100)



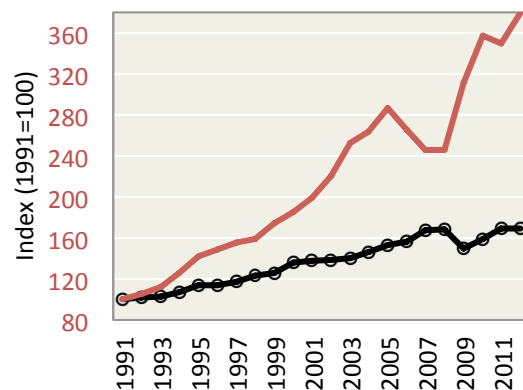
United Kingdom



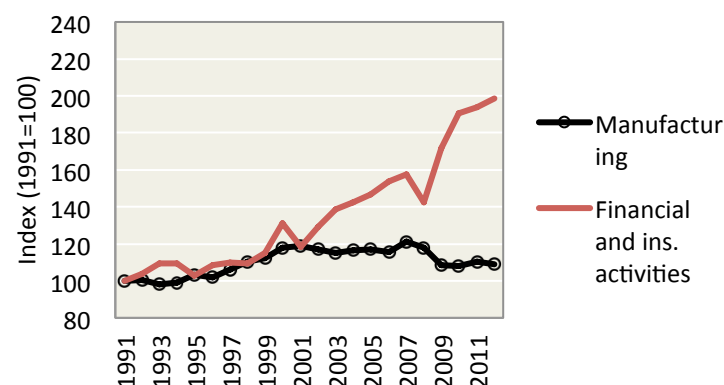
Germany



The Netherlands

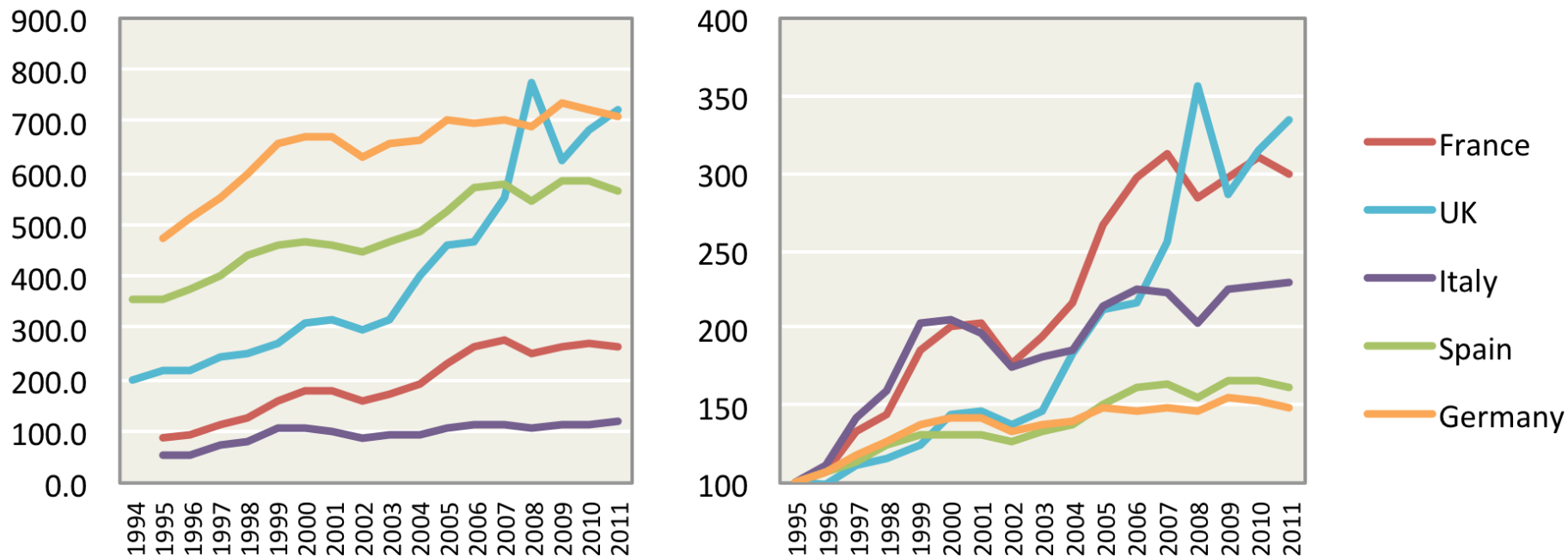


France



Source: Marco Veronese Passarella, "The process of financialisation: a comparison - Synthesis report, Part 3A," Version: 3.0, November 29, 2013. FESSUD Project, University of Leeds.

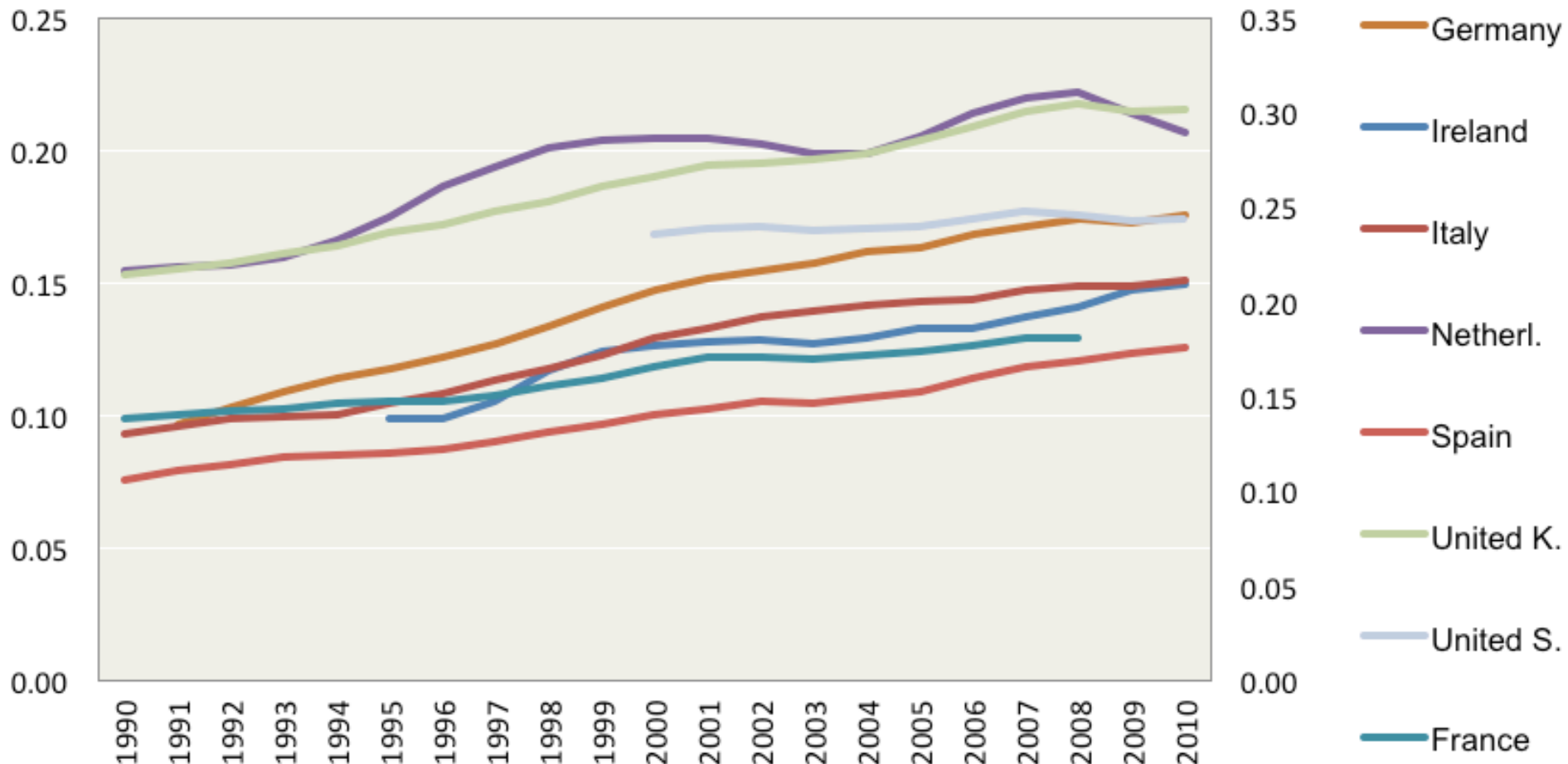
Figure 4. Financial assets to GDP ratios in top-5 European economies (left-hand chart) and its trend since 1995 (right-hand chart, Index 1995 = 100).



Source: our elaboration on OECD statistics (September 2013).

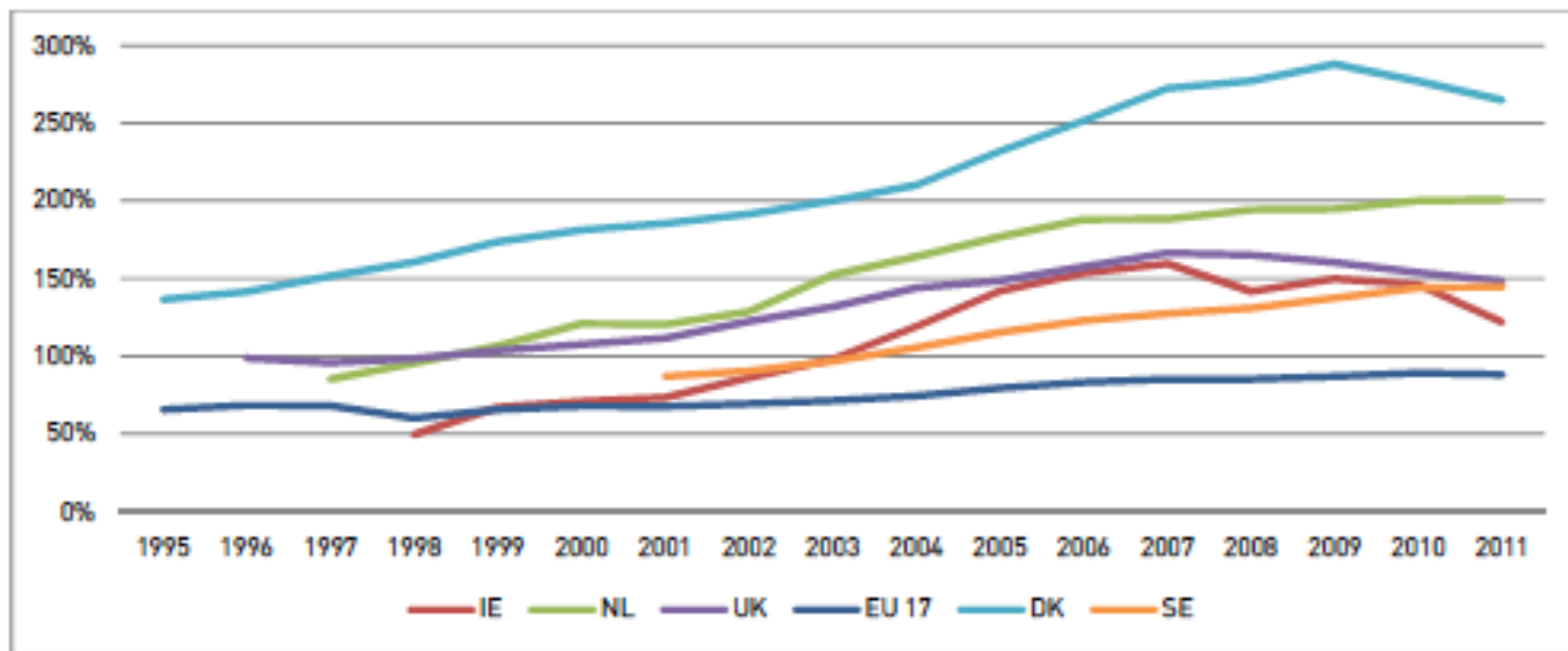
Source: Marco Veronese Passarella, "The process of financialisation: a comparison - Synthesis report, Part 3A," Version: 3.0, November 29, 2013. FESSUD Project, University of Leeds.

Figure 1. Employment in financial intermediation, real estate, rental and business activities, selected European countries (% to total)



Source: Marco Veronese Passarella, "The process of financialisation: a comparison - Synthesis report, Part 3A," Version: 3.0, November 29, 2013. FESSUD Project, University of Leeds.

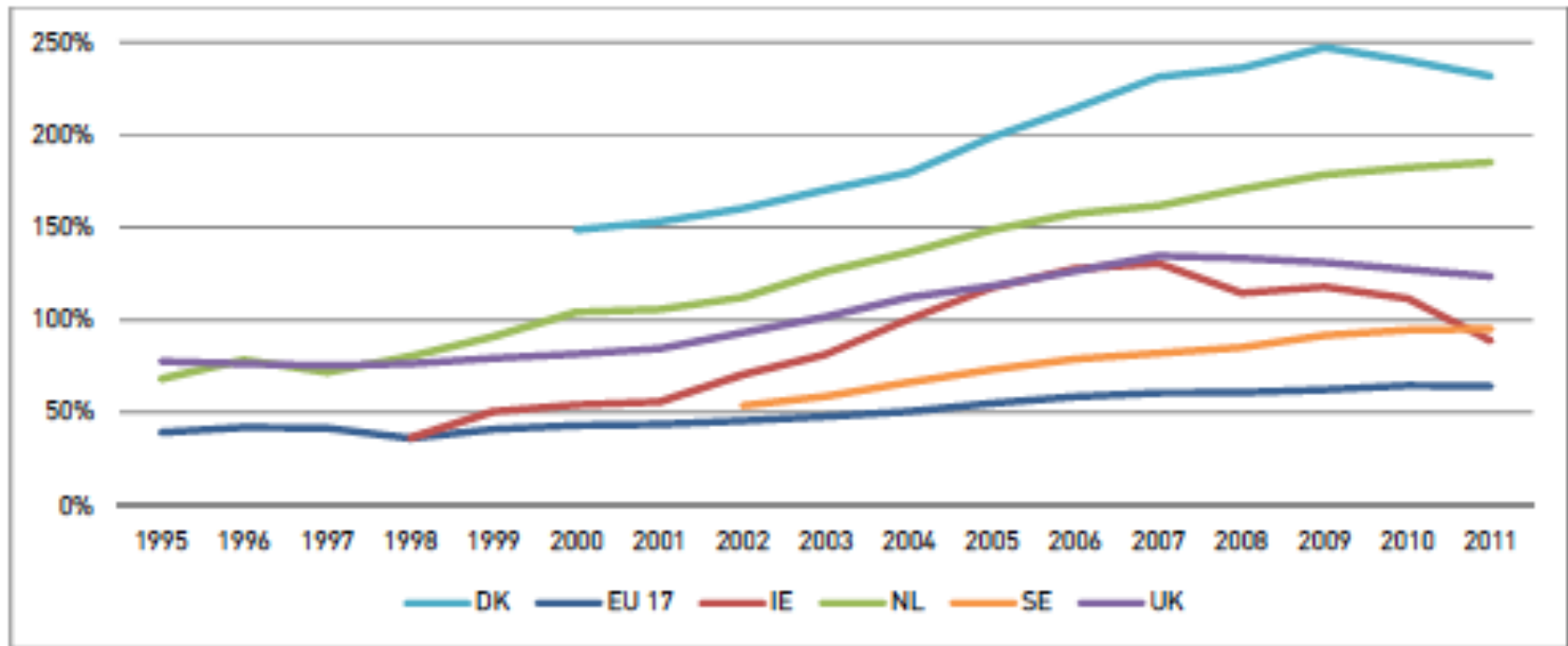
Figure 1 Household debt to disposable income 1995-2011: Early Financialisers



Source: ECRI

FROM: “Empirical Report on Cross-National Comparative Analysis of Household Financial Behaviour: Recent Trends,” FESSUD project, University of Leeds. November 30, 2013. Authors: Ana Santos, Ben Fine, Jennifer Churchill, Daniela Gabor, Mary Robertson, Serap Seritas, Nuno Teles.

Figure 5 Housing loans to disposable income 1995-2011: Early financialisers



Source: ECRI

FROM: "Empirical Report on Cross-National Comparative Analysis of Household Financial Behaviour: Recent Trends," FESSUD project, University of Leeds. November 30, 2013. Authors: Ana Santos, Ben Fine, Jennifer Churchill, Daniela Gabor, Mary Robertson, Serap Seritas, Nuno Teles.

2. The past and present of banking in Europe

- European banks themselves, caught between Wall Street and the City of London, are lobbying for maximum regulatory flexibility and no restraints (bonuses, bank size), while searching for new business models.
- Europe's financial system has not returned to 'normal;' it will not, and it cannot. 'Normal' banking was replaced in the 1980s and 1990s by a system that hurtled into the originate-to-distribute, securitization-driven, risk-hedged future so fast and furiously that no stability – no 'new normal' – was ever achieved.
- These developments are leading Eurozone member nations to a bifurcation point; the current structures of regulation and responsibility cannot coherently survive a next crisis that these structures make inevitable.

3. Approaching a bifurcation point in European finance

- The design of the Eurozone does not allow for central-bank liquidity provision for either the case of a meltdown in a national financial system or the case of budgetary deficits.
- Nation-states can use their banks' lending capacity as a short-term fix in crisis moments; but this compromises market confidence and leads to self-undermining dynamics.
- Either the possibility of unpayable obligations by banks whose liabilities exceed the carrying capacity of their national states is taken off the table, or megabanks' balance sheets are shrunk and their speculative activities reined in.
- Taking a crisis "off the table" requires that the ECB that is willing to play a lender-of-last-resort role.

3. Approaching a bifurcation point in European finance

- But the ECB will use its full powers to bail out troubled European banks only if these banks are European in scope. The “crisis off the table” scenario is one in which a small set of large banks with truly European market presence is operating.
- Here is the bifurcation point:
 - In one direction, a diverse eco-system of European banks, all operating at scales and in activities that do not pose risks larger than their national governments can handle.
 - In the other direction, a small set of homogeneous large European banks, offering similar products and services throughout Europe, operating adventurously in global markets, competing head-to-head with large Wall Street banks.
 - The judgement here: it is worth risking a systemic failure that cannot be checked to take some of the gains from the international financial center table: to be a global power requires power in global finance.

4. A sustainable banking future in a feasible Europe

- The rise of megabanks whose scale dwarfs national income flows has already happened; but continent-wide expansion by a small set of European (or non-European) megabanks has not.
- The large European banks that remain are lobbying for regulatory flexibility and for no restraints on bonuses and bank size. But the 2008 crisis shows that the capacity of European national governments per se to backstop new megabank recombinations and rescues - should not be exaggerated.
 - Ireland' response to its banking crisis has satisfied its bank creditors but crippled its fiscal capacity and led to a new round of outmigration, without guaranteeing the broad-based mortgage relief for the homeowners that bought the dream.
 - The UK has resolved its banking crisis only by doubling its sovereign debt and restarting its stalled housing bubble.

Figure 14: Assets of the largest domestic bank as a percentage of GDP, selected countries: 1989, 1997, 2004, and 2012 (1989 = 1.0)

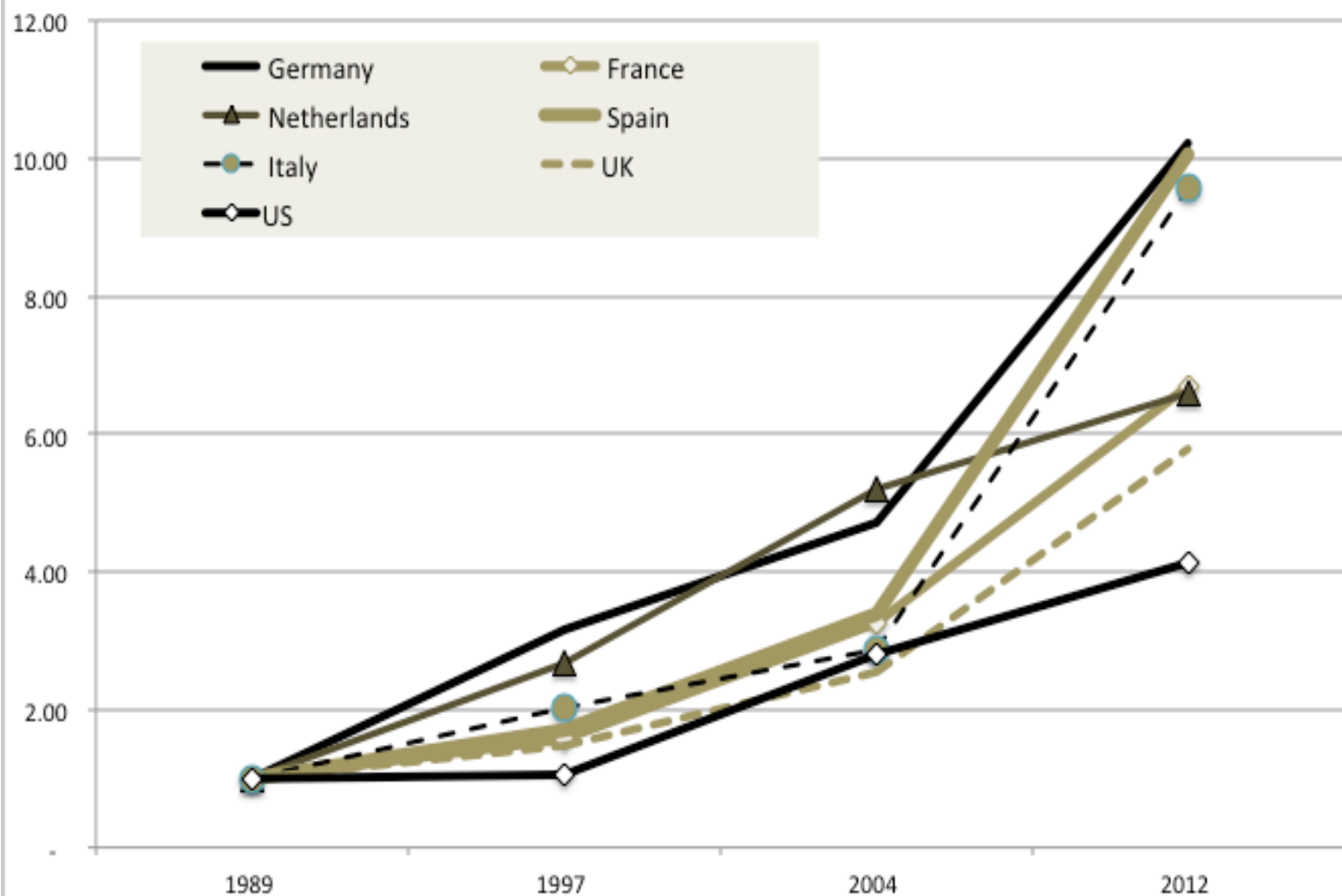


Figure 9: Net Loans and Leases as Percentage of Assets, Selected large bank holding companies, December 2007, March/June 2010, March 2012

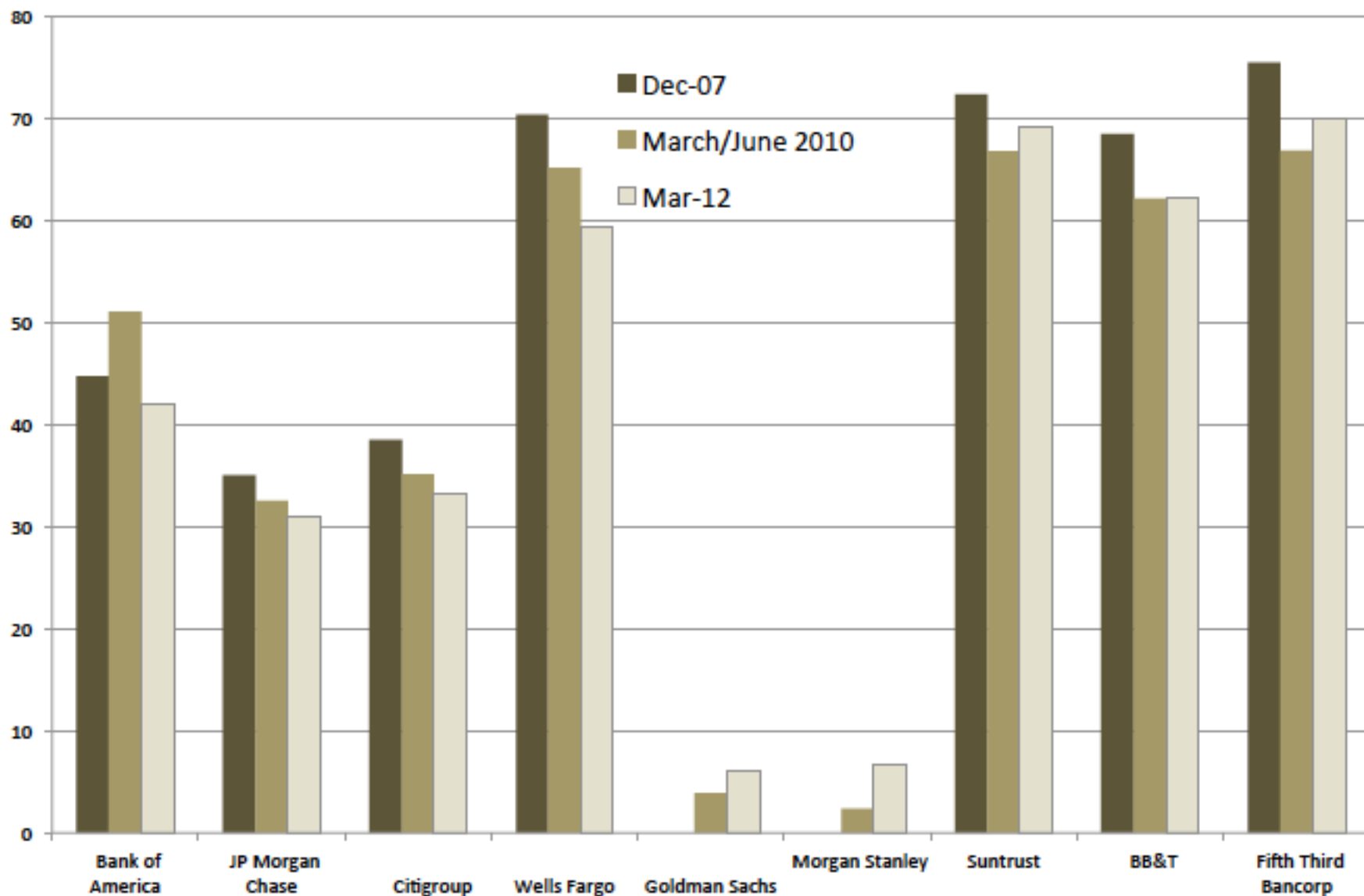
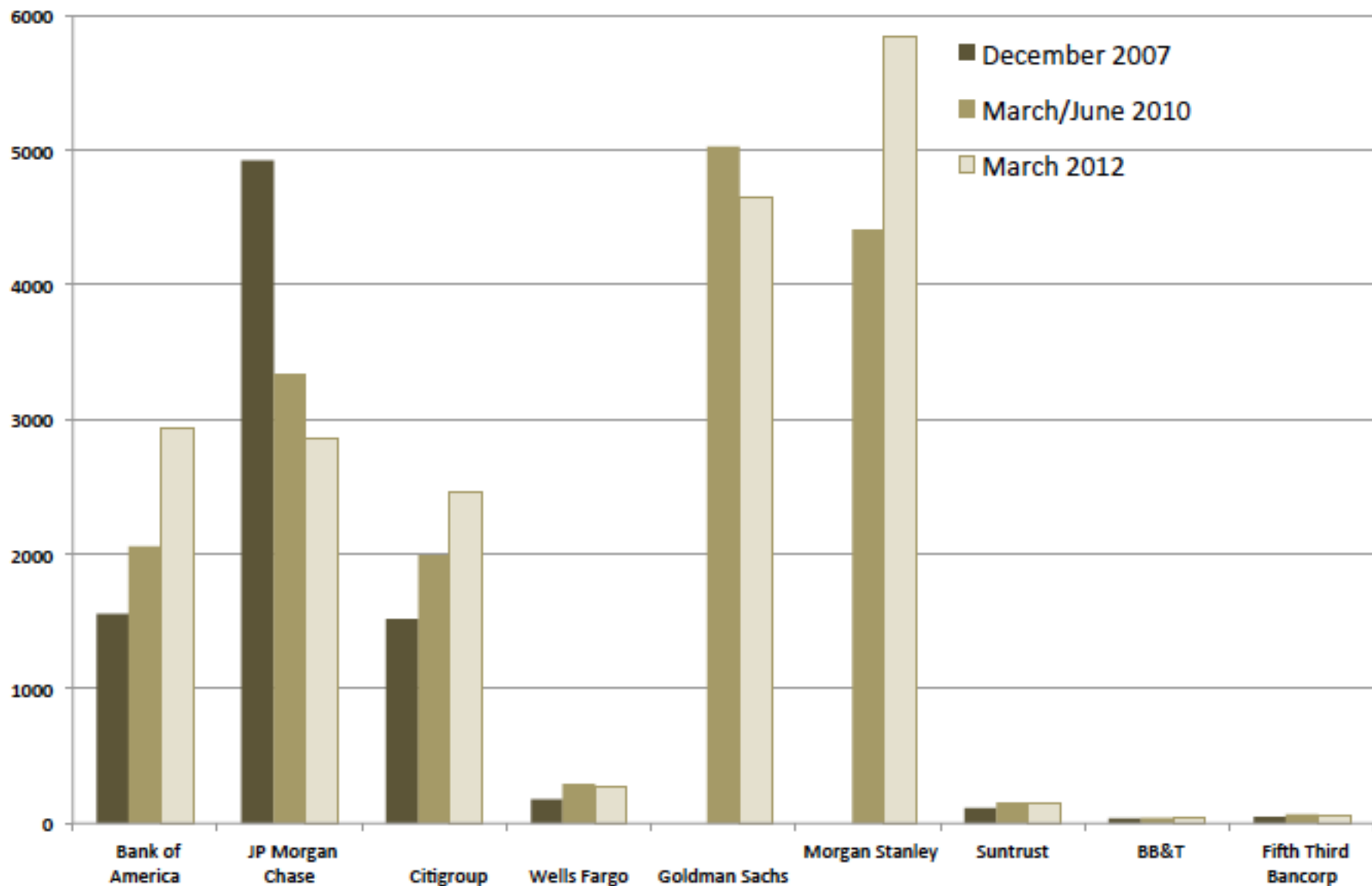


Figure 10: Derivatives as Percentage of Assets, Selected large bank holding companies, December 2007, March/June 2010, March 2012



4. A sustainable banking future in a feasible Europe

- European nations (& Europeans) will not embrace Europe-wide bank expansion, but those nations cannot backstop the megabanks they give rise to. They lack the fiscal capacity – and thus political capital – to orchestrate bail-ins their populations will support.
- The ECB will not step in to save jeopardized megabanks that operate on a scale any smaller than Europe.
- The only megabanks that might compete for global market share with Wall Street (currently, Deutschebank) necessarily operate on a sub-European scale.
- Europe's national governments have reached their sovereign debt limits, in part by taking on yet-undeclared bank losses.
- There is no political will in Europe for systematic fiscal transfers.

4. A sustainable banking future in a feasible Europe

IMPLICATIONS:

- Surviving large European banks cannot be left to compete with Wall Street and the City of London.
- The longer the City of London remains inside the Single Market but outside the Eurozone, the longer these contradictions fester.
 - Deutschebank or another European champion will continue trying to catch Wall Street's latest rabbits, until the Fed/ECB contradiction is exposed again.
- So it is no use thinking of restoring the 'normal' functioning of the banking system. The financial system has to be rebuilt, working from first principles regarding its purposes in the broader economy.
 - Democratic accountability and post-financial industrial policy are fundamentally important in this reconstruction process.

5. Policy proposals for more stable & equitable finance

Regulation and oversight of European banking/financial markets

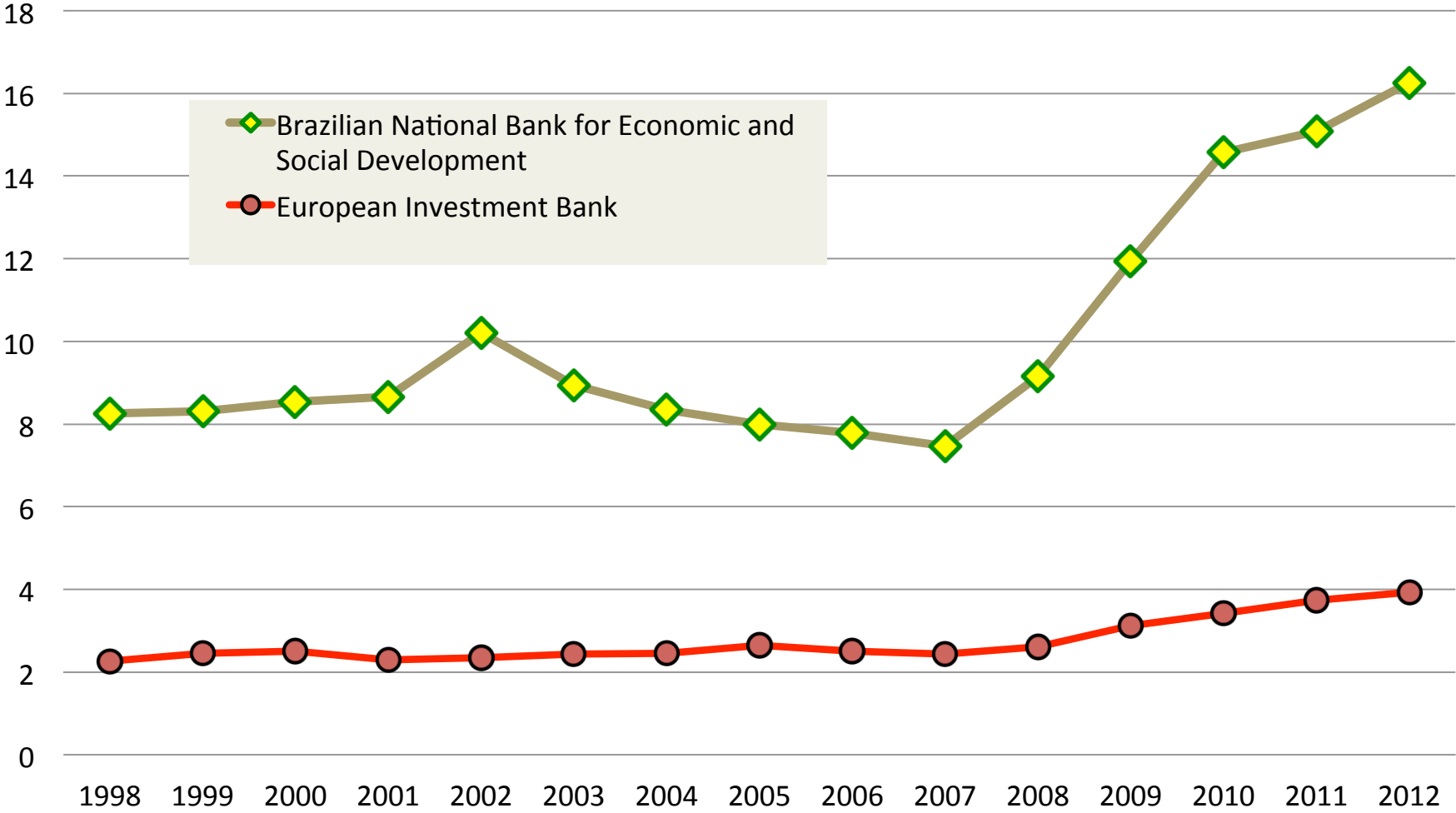
1. Eliminate excess financial risk-taking.
2. Rein in the activities and size of too-big-to-fail megabanks. Set size limits on banks' on-balance-sheet and off-balance sheet activities.
3. Gain regulatory control of shadow banking and of offshore financial-centre tax-havens.
4. Limit those forms of interconnectedness across national borders that can lead to destabilizing financial flows, make liquid markets brittle under crisis conditions, and exploit borrower firms and households in lower-income European areas, regions, and countries.

5. Policy proposals for more stable & equitable finance

Structure and functioning of European banking / financial markets

5. Encourage pluralistic banking systems to better meet local needs.
6. Retool the European Investment Bank (EIB) so it can better facilitate European economic and social development; and create national development banks that function as strategic allies both of the EIB and of member countries' governments.
7. Reform the mandate of the European Central Bank (ECB) to include employment targets, and make the ECB democratically accountable.
8. Rethink the forms, extent and terms of Europe's financial integration with financial centres and firms in the rest of the world.

Brazilian Development Bank vs. European Investment Bank (total assets as % of Brazilian and EU GDP)



5. Policy proposals for more stable & equitable finance

The financial rights and financial security of everyday Europeans

9. Set trans-European limits on predatory lending.
 - Rein in unregulated lenders who set payday and other lending rates at very high rates for economically vulnerable people.
 - Ensure that informal and lower-income lenders must comply with standardized limits.

10. Establish the concept of financial citizenship for Europe, including voice and exit rights for European citizens.
 - The citizenship concept should include:
 - the right to a bank account no matter the level of income
 - the right not to be subjected to predatory lending
 - the right to be protected from the threat of duplicitous, misleading lending offers and excessive fees.