

**SESSION « *REBUILDING CONFIDENCE IN FINANCIAL
MARKETS: FINANCIAL REGULATIONS, BUDGETARY
DISCIPLINE, MONETARY STABILITY* »**

**LET'S PRIVATIZE BANKS &
FINANCIAL MARKETS
AND
LET US NATIONALIZE
GOVERNMENTS & LET US
EUROPEANIZE REGULATORS**

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HOW WE GOT INTO THAT MESS?

- 1) Crisis erupted and originated in the most regulated sector: banking
- 2) Not in financial markets, with liquid products.
- Credit Bubble made possible but by the implicit bailout option enjoyed by the banking sector,
- This is a crisis of regulation

- **Culprits: banks, bank regulation and bank regulators**



**LET US PRIVATIZE BANKS AND
FINANCIAL MARKETS**

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LET US PRIVATIZE BANKS

- Root of the problem: implicit bailout enjoyed by banks.
- Enabled banks to take too much risks, to leverage too much, while knowing they would be bailed out
- « privatisation of profits, nationalization of losses » - that is a shame and a scandal
- → loss of public confidence
- This has to be changed : losses must be ascribed to the ones taking risks
- That will remove super profits and restore incentives

HOW TO PRIVATIZE BANKS 1: REMOVE SUBSIDIES

- For the parts of banks' liabilities that are « systemic » (deposits and short term debt), the implicit guarantee should be properly priced
- At the moment, deposit guarantee is priced ridiculously low (0,007% per annum in France)
- A proper price for this public guarantee would remove part of the superprofits of banks
- It is much better to make banks pay for their subsidized resources than having them paying for their risk taking (which is the EU policy now)

HOW TO PRIVATIZE BANKS 2: BANKRUPT BANKS

- Recent Basel 3 agreement not sufficient
- What is needed:
 - a proper **banking bankruptcy mechanism** where, quickly
 - - shareholders would be completely wiped out to absorb losses
 - - bondholders of banks' debt (junior and senior) should be called in through a debt-equity swap to absorb remaining losses and replace shareholders
 - **THIS IS ESSENTIAL** but is not an EU priority

HOW TO PRIVATIZE BANKS 3 : INCENTIVES

- To properly align incentives :
- Bonuses and profits should be kept in the banks' balance sheet, (ie be paid in equity)
- That would reinforce long term incentives
- That would strengthen banks' capital



**LET US NATIONALIZE
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REGULATORY CAPTURE

- Public regulator in the banking sector have been captured by the regulated banks
- Classical regulatory failure,
- Ex: in Basel 2, risk measurement delegated by regulators to the banks!

- Regulatory failure reinforced in EU by national regulators tendency to protect the local banks
- Banking is the most regulated sector → regulators have failed massively

LET US NATIONALIZE GOVERNMENTS

- Finance Ministries (Treasuries) are still too prone to take banks' arguments on board
- Banking regulation too soft as Governments want to protect their domestic banks
- Eg reluctance on banks' bankruptcy in Ireland

- It is time to take large public interest into account

LET US EUROPEANIZE REGULATION

- Offsetting national regulatory capture requires a strong EU reform
- First, failed national banking regulators should have been fired
- Second, we need a comprehensive EU banking regulations, hosted by the ECB
- → La Rosière report was timid and has been watered down
- We need a strong Eurozone banking regulator at the ECB
- With strong regulation (starting with banks bankruptcy)

CONCLUSION

- Response to the crisis:
- 1) Roles must be redefined. Back to basics:
 - regulators must regulate,
 - banks must be market based
- 2) Restore incentives, stop public implicit guarantees, bankrupt the banks if required

- That will be much more useful than banning short selling, legislating on bonuses and fighting fiscal havens (even if necessary)