Deleveraging and Structural Reforms: towards an ethical refoundation of finance

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Summary

1. Where we stand

2. How to alleviate the credit crunch

3. On-going reforms

4. The way forward
   a) subsidiarity
   b) supranational and global governance
   c) new players in finance
   d) new tools: the importance of business ethics
Exhibit 1
Deleveraging has only just begun in the ten largest developed economies
Total debt,1 1990–Q2 2011
% of GDP

Change
Percentage points

<table>
<thead>
<tr>
<th></th>
<th>2000–08</th>
<th>2008–Q2 2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>37</td>
<td>39△</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>177</td>
<td>20</td>
</tr>
<tr>
<td>Spain</td>
<td>145</td>
<td>26△</td>
</tr>
<tr>
<td>France</td>
<td>89</td>
<td>35△</td>
</tr>
<tr>
<td>Italy</td>
<td>68</td>
<td>12</td>
</tr>
<tr>
<td>South Korea</td>
<td>91</td>
<td>-16△</td>
</tr>
<tr>
<td>United States</td>
<td>75</td>
<td>-16△</td>
</tr>
<tr>
<td>Germany</td>
<td>7</td>
<td>1</td>
</tr>
<tr>
<td>Australia</td>
<td>77</td>
<td>-14△</td>
</tr>
<tr>
<td>Canada</td>
<td>39</td>
<td>17</td>
</tr>
</tbody>
</table>

1 Includes all loans and fixed-income securities of households, corporations, financial institutions, and government.
2 Defined as an increase of 25 percentage points or more.
3 Or latest available.

SOURCE: Haver Analytics; national central banks; McKinsey Global Institute
**Exhibit 2**

The composition of debt varies widely across countries

Total debt of ten largest mature economies, Q2 2011
% of GDP

<table>
<thead>
<tr>
<th>Country</th>
<th>Households</th>
<th>Nonfinancial corporations</th>
<th>Financial Institutions</th>
<th>Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan</td>
<td>67</td>
<td>89</td>
<td>120</td>
<td>226</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>98</td>
<td>108</td>
<td>210</td>
<td>81</td>
</tr>
<tr>
<td>Spain</td>
<td>82</td>
<td>134</td>
<td>78</td>
<td>71</td>
</tr>
<tr>
<td>France</td>
<td>48</td>
<td>111</td>
<td>97</td>
<td>90</td>
</tr>
<tr>
<td>Italy¹</td>
<td>45</td>
<td>82</td>
<td>76</td>
<td>111</td>
</tr>
<tr>
<td>South Korea</td>
<td>81</td>
<td>107</td>
<td>83</td>
<td>33</td>
</tr>
<tr>
<td>United States</td>
<td>87</td>
<td>72</td>
<td>40</td>
<td>80</td>
</tr>
<tr>
<td>Germany</td>
<td>60</td>
<td>49</td>
<td>87</td>
<td>83</td>
</tr>
<tr>
<td>Australia</td>
<td>105</td>
<td>69</td>
<td>91</td>
<td>21</td>
</tr>
<tr>
<td>Canada²</td>
<td>91</td>
<td>63</td>
<td>63</td>
<td>69</td>
</tr>
</tbody>
</table>

¹ Q1 2011 data.
² According to Canada’s national accounts, “household” sector includes nonfinancial, non-corporate business.

NOTE: Numbers may not sum due to rounding.

SOURCE: Haver Analytics; national central banks; McKinsey Global Institute
FINANCIAL BALANCES IN THE US ECONOMY, SINCE 1990
(per cent of GDP)
Have we learned the lesson?

- The etiology of the financial crisis
- “real economy”, financial and governance factors
- The break-down of trust
- The ethics of finance
2. How to alleviate the credit crunch: from stopgaps to structural reforms

• The conceptual framework: act either on alternative sources of funding or on the capital base

2.1 Public interventions: public funding of ailing banks; nationalizations; public guarantee funds; Monetary policies: QE, OMT

2.2 Recapitalizations, increase in savings, change in asset allocation (e.g. from real estate to private equity)
3. On-going reforms: strengthen the non-banking source of financing for SME and infrastructure

- **Main sources of financing:**
  - Bank loans
  - Bonds
  - Equity
  - Grants
  - Other (leasing, factoring, crowd-funding, PPPs)
3. On-going reforms: strengthen the non-banking source of financing for SME and infrastructure

- In EU 80% of financing come from bank loans, in the US only 20%: need for financial market reform in EU and emerging market economies

- Improve transparency, liquidity, and regulation of securitized products and credit funds (shadow banking)

- Mini-bonds, private equity, securitization of SME loans

- Long-Term investments: project bonds, LT investment funds, PPPs
4. The way forward
4.1 New forms of collaboration/division of labour between the State and the individual, the public and the private sector

- New welfare: public-private protection system
- Risk-taking and financing of last resort
- Guarantee schemes
- Tax incentives
- Regulations and supervision
- Risk and uncertainty (market failures)
- The ethics of responsibility: the role of leaders
4. The way forward

4.2 Governance

- The EU Banking Union: a challenging project with global relevance
- The G-20 commitments and their implementations
- T-TIP: a common transatlantic financial area?
- The increasing role of NGOs, business associations, new media and social networks, religious groups, civil society
- Glocal: local government and communities
- The international organizations: the UN, the Bretton Woods institutions
4. The way forward
4.3 New players in finance

• Pension funds and other institutional investors
• Private equity and venture capital
• Micro-credit and micro-insurance
• Small banks, cooperatives, mutuals
• Promoters, advisors, agents, brokers: the distribution claims
• Reverse mortgages, real estate and poverty (Desoto)
4. The way forward

4.4 New tools of financial performance: from a top-down to a bottom-up approach

<table>
<thead>
<tr>
<th>Top-down:</th>
<th>Bottom-up:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legislation</td>
<td>Education and training</td>
</tr>
<tr>
<td>Regulation</td>
<td>training</td>
</tr>
<tr>
<td>Supervision</td>
<td>Business ethics</td>
</tr>
</tbody>
</table>
Areas where investing in ethics is essential and urgent

- Leadership and management practices
- Human and social capital
- Corporate governance and corporate identity
- Compliance and control systems
- Compensation
- Corporate social responsibility
- The UN Principles of responsible investment and sustainable insurance
- Sustainability and the green economy
- Equal opportunities and gender balance
- Helping the poor and underprivileged
- Reputation and public confidence in finance
- Anti-corruption and money laundering

The fundamental role of the Catholic Church