Euphoric Credit and Finance: Merchandising time

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Paul H. Dembinski

Director - Observatoire de la Finance (Genève)
Professor - Université de Fribourg (Suisse)
President – Ass. Internationale pour l’Enseignement Social Chrétien
Queen’s question « Why did no one see the crisis coming? »

“It is difficult to recall a greater example of wishful thinking combined with hubris.” …

• “…But the difficulty was seeing the risk to the system as a whole rather than to any specific financial instrument or loan…”

• … “People trusted the banks whose boards and senior executives were packed with globally recruited talent and their non-executive directors included those with proven track records in public life…”

• …”They believed that the financial wizards had found new and clever ways of managing risks.”…

• … a failure of the collective imagination of many bright people, both in this country and internationally, to understand the risks to the system as a whole.

Quotations form a letter sent by the British Academy to Queen on the 22th of July 2009 answering the question posed by her Majesty during her visit to London School of Economics on the 5th of November 2008
Crisis or Accident?

As in case of every accident, there is many suspects and plenty to blame:

- “laws of history” – determinism, cycles
- Are “finance professionals” to blame ??
- Is shareholders’ appetite the culprit ??
- And what about economic and finance theories ??
- Insufficient internal and external controls ??
- Absence of regulatory teeth, self-satisfaction (and possible capture) of the regulators?

It seems that this crisis has many causes (Aristotelian multi-causality) possibly reinforcing one another => this is a systemic crisis

- Break down of a “systemic logic” which has to be revamped
- Exhausted model of “progressive” where “economic growth = happiness”
Three major confusions deepened during the Euphoric (1974-2007) decades

(1) Between Future and Present
- Leveraging the future for the sake of the present
- Endogenous time vs. exogenous time
  Today the future for some of us is empty

(2) Between Ends and Means
- More instead of “better”
- Ethos of Efficiency – obsession of ROI, ROE, etc…

(3) Between Reality and Vituality
- The dominance of the two dimensional world of “risk and return” – between quantity and reality

The visible effects: process of « financiarisation »
• Changing functions of finance in the economy:

- **Traditional function**: Allocate capital - productive efficiency
  - «real economy» flows of savings, investments and returns
  - issuers’ & bankers’ traditional business

- **Modern function**: Allocate & trade risks/rewards – discount the future and turn it into present (value)
  - Management of existing liquid assets
  - Traders’ and advisors business (capital gains)
  - Take care of existential fears (risk less society)
The expansion of the financial economy is a mere reflection of the tyranny of the real economy. Indeed, the tyranny of the real economy causes a lot of harm in many different places. It hampers the freedom of action of individuals. It forces them to cope with risks that jeopardise the well deserved rewards of their daily labour. It entails government intervention, which can be even more destructive.

...Today, the international financial economy removes the viscosity of the real economy. It puts economic agents in a position of responsibility by ensuring that they have the opportunity to accept those risks they are able to manage through the exercise of their particular skills. » (p5&8)

In 1999, Eric Briys one of the raising stars of financial theory, publishes « La mondialisation financière : enfer ou paradis » later translated as « The Fishermann and the Rhinoceros »
Financialisation is a systemic, socio-economic process:

- Creation on the basis of any possible fragment of ownership (material or legal) a financial asset (financial capital) governed by the newly discovered “laws” of financial markets, the entitled to returns and characterised by a level of risk;
- Is ongoing extension of the instruments and fields governed by the arbitraging of exit opportunities at the expense of commitment and partnership;
  - victory of “capital gain” view over the “flow of return view”
  - acceleration and shortening of perspectives: time as succession of independent “moments”
- Much more than only the growth of the financial sector (usual structural change);
Financialisation was a – tentative - answer to a growing demand (in the North) for risk management and returns:

- Risk management: beyond classical insurance: the promises of the risk-less society;
- Returns: Life without labour – rentiers eternal dream/illusion

Financialisation: search for low-correlated assets, notably in located the South

Financialisation is not only a technical/financial reality
Leverage
US: “real” vs. financial


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Growth leveraged by debt - Eurozone

Accroissement annuel de la Dette et du PIB
Zone Euro, 16 pays
(valeur nominale)

Nota Bene

Accroissement dette (2000-2010) = 8'811'949
Accroissement PIB (2000-2010) = 2'404'103

= 3.7
The same in US

Accroissements annuels de la Dette et du PIB aux Etats-Unis (valeur nominale)

Niveaux du PIB et de la Dette aux Etats-Unis (valeur nominale)

Nota Bene

Accroissement dette (2000-2010) 17'378'949 = 3.7

Accroissement PIB (2000-2010) 4708'925

Données Primaires : OCDE et Banque de France

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**Long term returns on assets below 1%**

**Finance is a fragile Industry – BIS AR 2010**

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### Profitability and leverage

**Medians across years and institutions**

<table>
<thead>
<tr>
<th></th>
<th>Return on assets¹</th>
<th>Return on equity²</th>
<th>Leverage³</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>95–09</td>
<td>95–00</td>
<td>01–07</td>
</tr>
<tr>
<td>Banks</td>
<td>0.6</td>
<td>0.7</td>
<td>0.7</td>
</tr>
<tr>
<td>Non-bank financials</td>
<td>0.9</td>
<td>1.0</td>
<td>1.0</td>
</tr>
<tr>
<td>Non-financials</td>
<td>3.2</td>
<td>3.0</td>
<td>3.4</td>
</tr>
</tbody>
</table>

¹ Return on assets: Median for the years indicated.
² Return on equity: Median for the years indicated.
³ Leverage: Median for the years indicated.
Transactionnitis

Ethos of efficiency pushed to its extremes

Flexibility – lowering “transaction costs”

- Progressive sterilisation, instrumentalisation of any relation
  - In finance – the subprimes
  - In employment relations; in inter-enterprise-relations
  - In start-ups and spin-offs
  - Even in academia; Not to speak of private life

Exit threat undermines trust, community and kills creativity

- Permanent focus on «exit» conditions, i.e. on liquidity;
- Permanent search for valuation of already achieved
- Attention diverted from the purpose
- Risk management becomes an obsession

Within large enterprises extreme proceduralisation

- Reporting and control,
- De-personnalisations of everything
- Knowledge management
- No room for ethics because no room for sense

Social and control costs skyrocket – limits to efficiency
Can/should financialisation be harnessd?

Discussion will go on for a long time:

Economists – mechanical problem (accident) or fatality «financial cycle» ;

Ethical perspective – human errors/misbehaviours

Natural limits for «borrowing the future» is a financial crisis, simply because it «cleans the books» - the Jubilee

Deleveraging: would free the future of many at the expense of destroying the (past) savings of also many. Massive deleveraging is redistribuive, can only succeed when it is «just» and systemic.

NB: The 1930 restructuring of WWI reparations came too late
The Global Finance & the Common Good

Manifesto of the Observatory of Finance that serves the common good

Thank you for your attention!!

Observatoire de la Finance
24, rue de l’Athénée
1206 Genève - Switzerland

www.obsfin.ch
dembinski@obsfin.ch