Banking Systems in the Crisis: The faces of liberal capitalism

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## The Empirical Puzzle

<table>
<thead>
<tr>
<th>Country</th>
<th>Change in Mkt Capitalization ($bn) 1999-2009</th>
<th>Bank bail-out package as a % GDP (March 2009)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Canada</td>
<td>97.5</td>
<td>0.0 %</td>
</tr>
<tr>
<td>Australia</td>
<td>85.6</td>
<td>0.1 %</td>
</tr>
<tr>
<td>New Zealand</td>
<td>NA</td>
<td>0.0%</td>
</tr>
<tr>
<td>USA</td>
<td>-676.1</td>
<td>6.8 %</td>
</tr>
<tr>
<td>UK</td>
<td>-244.3</td>
<td>19.8 %</td>
</tr>
<tr>
<td>Ireland</td>
<td>NA</td>
<td>43.0%</td>
</tr>
</tbody>
</table>

**Source:** *Financial Times*, 23 March 2009, p.9. 1999 values are as of 31 May 1999; 2009 values are as of 17 March 2009; Stewart 2009.
Defining our terms

- **Neo-liberalization**
  - The return to economic liberalism following the paradigm shift of the late 1960s and 1970s

- **Economic liberalization**
  - A process of macro-institutional change in which the central pillars of a country’s political economy shifts towards greater reliance on market-based coordination

- **Financialization**
  - A process of macro-institutional change in which finance serves as a driver of economic growth and assumes an increasingly important role in the political economy
Int’l Research Network on Varieties of Liberalism

- London Centre for Corporate Governance & Ethics (Birkbeck, University of London)
- Centre for Regulation & Governance (UC Dublin)
- Centre for Banking & Finance (University of N. Carolina)
- College of Law & College of Business (Uni. of Illinois)
- Critical Laboratory in Law & Society (York Uni., Canada)
- Centre for Law, Markets & Regulation (University of New South Wales, Australia)
- College of Business (Massey University, New Zealand)
• Part One: Introduction
  – The ‘not so global’ crisis
  – The return of ‘financialized’ liberal capitalism

• Part Two: Country Case Studies
  – How the institutional configurations in each country – and their financial systems – influenced the outcomes of the twin processes of financialization and neo-liberal reforms

• Part Three: Analysis & Conclusions
  – Institutional foundations of the Anglo-Saxon banking systems: Some are more liberal than others
  – The ‘Ordoliberal’ variety of neo-liberalism
  – Conclusions
Economic Liberalization

• Canada’s 1964 Porter Commission
• The 1970s return to economic liberalism
  – US discontinues gold backing of the American dollar, leading to the collapse of Bretton Woods
  – UK introduces policy of ‘Competition & Credit Control’ and makes a ‘Dash for Growth’
• Radical liberalization in the US, UK and Ireland
  – ‘Reaganomics’ and ‘Thatcherism’
  – Awakening the ‘Celtic Tiger’
• Pragmatic liberalization in Canada, Australia & NZ
  – Social Democracy, ‘Economic Rationalism’ and Rogernomics’
Institutional Effects of Liberalization

• Changing role of the Central Bank & Central Government
  – Central Bank granted operational independence and assigned responsibility for monetary policy (price stability)
    • US, UK & Ireland: Central Bank power was extended beyond deposit-taking institutions
    • Canada, Australia & NZ: Separate regulatory agencies were set-up early-on to deal with non-bank financial entities
  – Central Government assigned responsibility for maintaining market freedom
Institutional Effects of Liberalization

- Financial Market liberalisation & regulation
  - Canada, Australia & NZ: Incremental & prudential

- Structure of Financial Market Regulation
  - UK, Ireland & NZ: Unified
  - Canada & Australia: ‘Twin Peaks’
  - USA: Fragmented
Changes in Firm Behaviour

• Financial Conglomeration via Mergers & Acquisitions
  – US, UK & Ireland
    • Internationalization & Bifurcation
    • Investment banks manage commercial banking activities
    • Regulatory challenges:
      – ‘Too big to fail’ dilemma
      – Threat of regulatory arbitrage
      – Shifting power relations & regulators’ conflicting objectives
  – Canada, Australia & NZ
    • Large domestic banks dominate
    • Commercial banks manage investment banking activities
    • Regulation much more straightforward
Changes in Firm Behaviour

• Change in Banking Business Model: ‘Originate & Distribute’ replaces ‘Originate & Hold’
  – US, UK & Ireland:
    • Drive for profits & short term share price appreciation
    • Shadow banking reduces regulatory capital holdings
    • Financial innovation & securitization encourages risk taking & easing of credit standards, esp in US and Ireland
  – Canada, Australia & NZ:
    • Shareholder pressures unimportant
    • Conservativism in Banking Practices
    • Little enthusiasm for shadow banking & financial innovation
• ‘Regulatory Dialectic’ Effects
  – Australia’s ‘corporate cowboys’
  – The American Savings & Loan crisis
  – Canadian and British bank, insurance trust & investment house failures
  – Looking into the abyss...
Macro Feedback Effects

% of total income earned by top 1%

Source: Alvaredo, Atkinson, Piketty and Saez, ‘The World’s Top Income Database’
Macro Feedback Effects

• Financialization & industrial restructuring
  – Deindustrialization, wage & income stagnation
  – Diversion of investment funds towards speculative uses
  – Unbalancing the production & financial sides of the economy

• Financialization & the political process
  – Prioritization of financial interests (& the wealthy)
  – Marginalization of left wing movements & parties

• Financialization of households, workers & the poor

• Cumulative causation ...
Concluding Thoughts

• Financialized Neo-liberalism Assessed
  – Markets are social and political constructs – even ‘laissez faire’ is a policy decision – So in whose interests are markets designed to operate?
  – Inherent tendency towards macro-economic imbalance and inequality – But how far is this from instability?
  – Direction of change comparable, although pace and intensity varies across the LMEs – But what about the future? Dodging one bullet is no guarantee of survival.

• LMEs can develop different institutional responses to a common external shock
Where is liberal capitalism heading?

• The ‘Alternatives’ within
  – What are the alternatives paths of development latent within the LME model?
    • Financial systems
    • Economic and industrial policy
    • Corporate law
  – Are these alternatives politically and institutionally feasible – and what are the forces that make them more (or less) likely?