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12 Theses on European Financial Market Regulation



Imprint

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Introduction

The importance of the financial sector for the global economy has increased significantly throughout the past decades, while also taking sizeable resources and attention from other crucial parts of the economy. The consequences of the global financial crisis 2008 were and continue to this day to be enormous:

- Both for the **real economy** – e.g. in the form of high unemployment and stagnating, or even decreasing income
- as well as for **government budgets** – e.g. in the form of increased government debt and the associated interest burden
- Some hypotheses, which were unfortunately taken as granted by neoliberal mainstream economists as well as by many economic policy makers, have proved to be wrong in reality.
- The potentially negative effects of financial markets on the real economy have been massively underestimated or fully ignored.
- The self-regulating and self-stabilizing powers of financial markets were overestimated, especially in regards to the fact that market failures are a common characteristic of financial markets.
- Economic crises emanating from financial markets are those that have the greatest impact and spread most worldwide. **Unregulated financial markets do not contribute to stabilising the real economy.** Financial markets often suffer from harmful herd behaviour. Unregulated financial markets tend to intensify a crisis: in good times they fuel excessive (credit) growth and in bad times they accelerate the downward spiral.
- Risk in financial markets is often non-transparent. Many financial instruments are often unnecessarily complex and opaque; instead of spreading risk better, they may further conceal it. The actual risks are therefore easily underestimated – which has serious consequences.
- When banks become too big, it may no longer be possible for the public sector to save them due to budgetary reasons – “too big to fail” can thus also become „too big to bail/too big to rescue“.

A new consensus?

In response to the financial crisis, a new consensus in the economics discipline and partly in politics has emerged that contradicts the previous overreliance on self-regulating markets that revolves around:

- The need for strong financial market regulation: The state must play an important role in the financial sector; state interventions against market failure are necessary and accepted today.
- The integration of financial markets on a global scale allows for better risk diversification, but at the same time allows for faster contagion in the event of a crisis and leads to the transfer of risks to other countries.
- Credit is important for the efficient functioning of a market economy, but excessive credit growth is dangerous and can lead to bubbles and failures in financial markets. The excessive increase in personal indebtedness (of companies and individuals) and not the often-mentioned public debt was responsible for many financial and economic crises in the past. In most countries, public debt only increased after the crises due to expensive bank bailouts and the economic recession.

The concentration of huge financial assets in the hands of a very few funds (e.g. Pimco, BlackRock) means they no longer hold significant stakes only in individual companies, but in all market leaders of a certain sector. In order

to achieve maximum returns from these investments as a whole, they exert their influence in such a way that competition between companies is limited, which harms consumers.

Financialization of the individual

For instance, in the Anglo-Saxon area, people are already dependent on the financial market in many spheres of life: Educational loans, private health insurance, pension insurance, etc., whereby the individual's fate depends directly on the financial markets. This strong financialization of the individual is currently not present in Austria due to the social democratic policies of recent years. Many services (housing, pensions or health) is ensured by stable public services that is not profit-oriented. This independence from the financial markets is massively endangered by the ÖVP-FPÖ government.

Diversity and Rationality in the Austrian banking sector

In the Austrian banking sector, diversity is more prevalent than in other European countries such as France or the Netherlands. As a result, the provision of banking services – even in structurally weak regions – and the choice for consumers is greater.

Importance of budget and fiscal policy

The financial sector and the real economy must be considered together politically; only the good interaction between financial market regulation and budgetary/fiscal policy can ensure effective overall control. In the EU, the consequences of the global economic crisis following the financial crisis were further exacerbated by a restrictive fiscal policy – the infamous austerity –, which caused long-term stagnation; while in the US the Obama administration relied on expansive fiscal programs and therefore coped with the crisis in the US more quickly and decisively.

The Maastricht criteria and the fiscal pact in the EU have made it difficult for governments to stimulate the economy and through investment to escape the crisis period. A new consensus is now emerging here as well: If the central bank is already at the limits of its possibilities at a zero interest rate, active fiscal policy should be pursued to get out of a long recession more quickly. The prolonged stagnation of the Eurozone economy was a consequence of the political priorities and views of conservative and neoliberal forces. This has costed the European economy and the European population much in terms of economic growth and income and has thus indirectly contributed to the influx of populist movements.

The real economy needs a functioning, robust financial sector that serves the provision of goods and services economy and not just itself. We all need stable financial markets to avoid suffering the fatal consequences of financial crises. Good financial market regulation is a central factor for this. In the following, we therefore present 12 theses on financial market regulation from a social democratic perspective.



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From a social democratic point of view, financial market policy should serve the real economy and ensure crisis prevention and thus system stability. The 2009 G20 summit in Pittsburgh set high standards for financial market regulation in response to the financial crisis of 2007-08¹. While undeniable progress – higher capital ratios, more intensive banking supervision – was achieved, much remained piecemeal. After the financial crisis seems to be over, more and more voices are calling for deregulation and less supervision, and some policymakers listen. Social Democracy must decisively address both fragmented regulation and the trend towards deregulation – forerunners of the next crisis.

The following **12 theses** are intended to serve as **guidelines for a social democratic financial market policy in the 21st century** to enable a socially just and economically stable financial sector:

1.

Lack of courage to simplify – complex markets meet complex regulation: Complexity benefits financial market operators as they successfully use lobbying or court procedures to find exceptions or loopholes. Complexity leads to even more „too big to fail“ because only the big companies can afford the compliance and legal advisory services to understand and exploit this regulation. The courage for simplicity is missing: effective regulation would require simply forbidding or controlling more strictly certain products and practices. There is a lack of political will and daring. Politicians seem to believe financial lobbyists who allege that capital was a shy deer fleeing from additional regulation in Europe. Politicians underestimate their own room for maneuver and are afraid of introducing and implementing wide-ranging rules. **Social Democracy must work for simple, comprehensible regulation and their effective implementation.**

2.

„Too big to fail“ is still a reality: The promise to break up huge financial companies so that they are no longer too large to be settled in an orderly manner or go bankrupt was not fulfilled. Giants like Deutsche Bank would continue to trigger serious systemic crises should they find themselves in serious economic trouble. Nor is this market failure corrected by competition law. Politics must work out effective solutions in exchange with science.

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3.

Bail-in instead of bail-out does not work (yet): Before the financial crisis, the high profits were gained by a few shareholders. During the financial crisis, the massive losses were often borne by the public sector and thus socialized. It was a big promise from policy makers that in the future taxpayers never again have to foot the bill for bank bailouts. As recent cases show, the fulfillment of this promise has so far been doubtful at best. Politicians must find the courage to use creditors to carry losses and thus make it clear to them that higher interest rates or returns are always associated with higher risks. **It is important to allow the regular exit of banks from the market if necessary.** Mechanisms must be created to prevent retail investors disproportionately financing bank crises (rather than large shareholders). **Existing gaps in the European legal framework must not erode the polluter-pays principle.**

4.

There was no debate on the socially desirable structure of the financial system – speculative and risky investment banking continues to be „cross-subsidized“ by savers' deposits, in one and the same bank. The system of deposit insurance, which is important and necessary in its own right, contributes to the distortion of risk and thus to speculative behavior on the part of both the bank and the savers². Apart from attempts by the new ECB Banking Supervision to „clean up“ a few problematic banks, there has been no fundamental change in the banking industry. A number of major banks continue to dominate the market and, not infrequently, the political agenda. On the other hand, small cooperative banks are struggling to survive, but they are silent on the fact that they often participate in the same speculative dealings as many major banks through corporate links. **Social democracy must develop and advocate a vision of the financial system that serves the real economy, and act against pure financial speculation.**

5.

The general role of the bank as a financial intermediary was not questioned. Why lending and deposit should still be organized in the Internet age as decades ago, is at least to be discussed critically. Currently, policymakers are at risk of being overrun by digitization and fintech developments, which are increasingly driven by US Internet giants, where traditional competition law may not suffice to guarantee fair markets. In particular, **social democracy needs to examine whether state solutions would not be superior to private sector ones, as in the case of other public utilities** (unlike public promotional banks for businesses, there are no such **public promotional banks for individuals**).

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6.

Lobbyists of finance capital have an immense influence on regulation: far too often put lobbyists of banks, insurance companies and investment service providers their concerns into the European institutions. The same applies to national governments, where finance ministries all too often confuse the interests of representatives of domestic banking groups with the „national (pseudo-public) interest“. Related concerns of consumers, savers and employees have no voice in Europe. **Social democracy must enforce stricter rules for lobbying, more transparency and representing the interests of consumers, savers and the general public.**

7.

Independent financial expertise is rare and not always easy to identify. There are still some experts pretending to be committed only to scientific progress, but who in fact have a rather close relationship to the financial industry, which they occasionally fail to disclose. Some even depend on contributions by banks or other financial institutions for funding their work. Critical scientists who are willing to oppose mainstream views are sometimes risking their tenure. Particularly in a field of this utter importance to the social, economic and financial stability, **the government should secure independent research and advice and provide the necessary funding for the respective institutions.**

8.

Free movement of capital is not a sacrosanct end in itself. In some cases, capital controls limiting this free movement can be warranted. When the crisis hit Greece and Cyprus, the taboo of capital controls was broken and depositors' access to their savings was limited. However, the political will and/or courage to rein the capital flows of large financial investors – if necessary - is missing. **Social democrats should deliberate – in close cooperation with economic research – the possibility of capital controls in the interest of effective financial market regulation.**

9.

Under the current rules, capital gains are not taxed fairly. Wage earners are bearing the brunt of taxation in all countries, whereas international financial market actors often find easy ways to avoid their taxation. A financial transaction tax would be a first step in the right direction and should be implemented as soon as possible. Cross border transactions that merely serve the purpose of tax avoidance should be ruled out. **Social democrats must fight for a fair taxation of all financial market participants.**

10.

Financial literacy is spread very unequally among the population. In order to act as responsible consumers, citizens must have access to the appropriate financial education, which should be taught at school. Everyone should be aware of the trade-off between risk and return and similar basic insights. However, raising financial literacy should not become a justification for financial markets to shift an undue share of financial risks to households. **Social democrats should favour financial literacy programs in school curricula and its inclusion in the educational programs of public broadcasting.**

11.

The European banking union is still fragmented. Crises that affect the whole of Europe need European solutions. For social democrats, the development and completion of the European banking union is of highest importance. The banking union, which consists of the three pillars single supervision, single resolution and common deposit insurance³, is still unfinished business. The implementation of the single supervision with the ECB – as already existing European institution – becoming a single supervisor was a first success. Building a European resolution system with a prefunded resolution fund to prevent future burden for European taxpayers has become a race against time (see theses 2 and 3). The system in place by now could not cope with a new financial crisis. The European deposit insurance as the third pillar is still missing. **The European banking union must be completed as soon as possible.**

12.

The primacy of democratic policies over economics has been lost. Although financial markets could only be saved by public sector interventions – often at the expense of the tax payers – , again and again policy makers are influenced by market participants to drop useful regulations because lobbyists present surreal horror scenarios like a devastating “credit crunch”. **The overarching objective of social democratic financial policy is to re-establish the primacy of democratic governance.**

Footnotes:

1. <https://www.oecd.org/g20/summits/pittsburgh/G20-Pittsburgh-Leaders-Declaration.pdf>
2. Since deposits of up to € 100,000 are secured by the deposit insurance, many savers put their savings on „savings accounts“ of more risky banks – with higher interest rates – as they would do without deposit insurance.
3. SSM (Single Supervisory Mechanism)
SRM (Single Resolution Mechanism)
and EDIS (European Deposit Insurance Scheme)

Conclusion

For social democrats, it is important to leave financial market regulation not to neoliberals or conservatives – be it politicians, bankers or experts. As the crisis has shown, severe losses in any major bank could result in costs to the public sector that exceeded the budget balance of an ordinary year. While profits are still kept private, some local banks are kept artificially alive by their governments with taxpayers' money.

Absurdly, in political terms the beneficiaries of the crisis were populist or conservative parties. This might be the case because social democratic parties are not seen to be very active in economic policies in general and in financial market policies in particular. As issues of public safety and homeland security became more dominant in the political debates, it is worthwhile to note that the fiscal costs of aiding and sheltering refugees is a fraction of the costs necessary to save a medium-sized bank in Europe.

Social democratic financial market policies can only be designed at the European level, the actions of national governments alone are not very promising. Our collective goal must be to assure social justice by stabilising the financial sector, preventing crises and fostering real growth.

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